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ECONOMICS

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LESSON 1

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By

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ECONOMICS

LESSON I

Fundamental Definitions.

IN this materialistic age it may seem unnecessary to insist upon the importance of the economic factor in human life. Yet the average man scarcely realizes how profoundly his own life and its circumstances are modified, not only by his individual financial position, but also by the accumulated wealth of the society in which he lives. His house may be lighted by power generated at Niagara and brought to him over a transmission system which has cost millions of dollars to produce; it may be heated by coal mined hundreds of miles away and conveyed to him over an enormously expensive system of railways and steamships. But such stupendous investments of capital as are sunk in the American or Canadian railway systems would have been quite impossible half a century ago, for the whole wealth of these countries at that time would have been insufficient to construct these great railways. In order that such railways should exist for the public service, it was necessary that billions of dollars should be saved from the incomes of citizens of these and other countries, and then invested in the building of railways. If this money had not been saved and invested, our modern transportation system could not have existed, and our householder—our consumer—would have had to pay more dearly for those commodities which must be brought to him from a distance. Our producers in all lines of effort would have been restricted to the narrow local market for their goods, and, because of the limited number of consumers, production on a large scale, with its consequent cheapness, would have been impossible.

Such investments as these mean not only greater cheapness of commodities; they often involve for a community the preservation of life itself. In China, where there are as yet very few railways, the people of a famine-stricken province die off by hundreds of thousands when grain is going to waste within a hundred miles of them. In India, where under the British occupation 25,000 miles of railway have been built, corn can easily be rushed into a famine district, and the widespread famines which used to desolate the country are almost a thing of the past.

Nor is the economic advance of man without influence on his higher life. Compare the primeval man or the savage of to-day with the citizen of a civilized community. The savage lives usually from hand to mouth, has no leisure for thought, is unable to turn to account the natural forces which he sees in operation around him. He is usually short-lived, liable to attacks of epidemic disease, ignorant and improvident, almost as much at the mercy of nature as are the lower animals. Take away his accustomed food, and he perishes; restore it, and he multiplies; transfer it to another region, and he must follow, as our Indian tribes used to wander after the herds of buffalo over the vast plains of the West. In such a society neither art, nor literature, nor religion, can ever flourish. These imply the existence of individuals who do not need to devote all their time to the mere securing of food; the life of the savage is so precarious that no one can be spared from that most necessary work of "keeping the wolf from the door." Hence no considerable degree of mental development has been or can be attained in a primitive community.

At a comparatively early period, however, the most enterprising nations found it possible to withdraw a number of their people from actual manual labour and dedicate them to the pursuit of what we often call "the higher things of life." The rest of the population became mere hewers of wood and drawers of water for these favoured individuals, and toiled throughout long centuries to provide its lords and masters with the wherewithal for a refined and luxurious existence. Slave labour was the material basis of the splendid civilizations of Greece and Rome. The many were sacrificed in the interests of the few. Only thus were those early civilizations possible, for the means of production were so primitive and laborious that leisure and the comforts of life could not as yet be provided for the masses of mankind.

Within the past century man's increasing control over the forces of nature—his ability to make them work for him—has enormously increased the production of wealth in civilized countries. The average money income of the English family of five persons is now $1,000 per annum as against $375 in 1820, and owing to the greater cheapness of commodities, this $1,000 will purchase nearly as much as $2,000 would have purchased in 1820. In a word, the average English family is from four to five times as well off as it was a century ago. Its income has from four to five times the former purchasing power. (See Marshall's Principles of Economics, 5th edition, page 751, note.). This fact is of tremendous significance. It means that we have reason to hope that in the course of time an ever-increasing portion of our people will be released from the drudgery of mechanical manual labour and will be able to devote a large part of their time to public affairs, literature, art, science and religion. The utilization of the elements in the service of man is giving us the necessary economic basis for a real democracy in which all the citizens will be men of education and culture.

The Problem of Poverty.

We are still far from attaining this ideal state of affairs. Even in such a wealthy country as England a large portion of the population does not possess a sufficient income for a decent existence. Booth's exhaustive and scientific enquiry into the "Labour and Life of the People" showed that 32%—practically a third—of the whole population of London lived in a state of poverty "incompatible not only with the elementary conditions of civilization and citizenship, but with physical health or industrial efficiency." The greatest of the social problems which confront England to-day is how to raise these people from the degradation and pauperism into which they have sunk, and make them efficient and industrious producers, self-supporting and decent citizens. Hundreds of scientific economists, thousands of disinterested social workers, are giving their time and attention to the solution of this problem, and the mass of ignorance and vice is gradually being diminished. But not so quickly as one would wish, for the difficulties are many and formidable.

"The destruction of the poor," we are told, "is their poverty." The poor man is unable to educate his children, and therefore they remain at the bottom of the social scale. They are sent into the factories or put to work on the farm before they have passed the entrance examination, and often before they have attained the age of fourteen. Always, of course, a few of the abler and stronger-willed triumph over their handicaps, educate themselves and finally attain distinction. That has always been the case and always will be. But the average boy, when placed in such a situation, accepts it and remains throughout life in the position of an unskilled laborer, whose work is worst paid and most precarious, since the supply of such labour is nearly always in excess of the demand. A poor education, then, makes an inefficient producer; that inefficient producer is poorly paid, and consequently his children also have very limited opportunities of education. They in turn become inefficient producers, receiving low wages, and thus poverty is perpetuated from one generation to another.

The only satisfactory way to deal with this terrible problem of poverty is for a nation to do everything in its power to bring all its citizens to the highest degree of productive efficiency by giving them all possible educational advantages, especially along the lines of scientific, agricultural and technical and business training. This is now widely recognized both by governments and individuals. Such institutions as the Ontario Agricultural College and the Toronto Technical School far more than repay the comparatively small cost of their maintenance. Besides their direct influence on their graduates, they also influence indirectly all with whom these come into contact, creating better standards of farming and of workmanship. These standards are in time accepted throughout the country, whose wealth is thus enormously increased.

To sum up, then, wealth is exceedingly important to a nation as to an individual. With wealth as a general thing are associated civilization, knowledge and even virtue; with poverty, barbarism, ignorance and vice. The great Greek Philosopher, Aristotle, said that a certain amount of external goods was necessary to the development of virtue. This opinion has its modern echo in the question so often heard in the England of to-day, "Can a man be a Christian on £1 a week?"

The Science of Wealth.

Political economy is the science of wealth and treats of how wealth is produced or may best be produced by man, and how it is or ought to be distributed among the various classes who contribute to its production, and finally how it is or ought to be consumed. It may also be defined as the science of man regarded purely in his economic function as a producer, distributor and consumer of wealth. It is thus a part of the study of man.

Now the real man as we know him is never purely a producer, distributor and consumer of wealth. He has usually religious or political feelings, artistic, literary or possibly military ideals to which he is at times ready to sacrifice all his economic interests. He does not always act as he would if he were simply and solely a money-getting machine. So that the conclusions reached by the political economist as to the probable action of men under certain circumstances are always liable to be overturned when brought to the test of fact. In the Dominion elections of

1911, many people voted against reciprocity on other than economic grounds.

The average man, then, is not simply and solely a money-making animal, but he does tend to be such in his business relations . He is "not in business for his health," he is in business to make money, and good business men, when they are philanthropists, prefer to keep their business separate from their philanthropy. The sure way to bankruptcy, they tell us, is to mix business with charity. They would rather pension off an aged employe who had served them in the past than keep him on at work in a position where he could not earn his pay and was all the time making mistakes. The business man, then, in so far as he is simply a business man, aims at making the largest possible profits on his aggregate trade. If he sells some things at a small profit or at no profit at all, it is because he expects by this means to increase his trade, widen his circle of customers, and secure a larger total profit.

The so-called "soulless corporation," which is now controlling most of the larger business enterprises throughout the civilized world, is even less likely than the average business man to be influenced in its actions by non-economic motives. Its aim is simply and solely to make money for its shareholders; its officials are the paid servants of the shareholders, and have no right whatever to grant specially favorable treatment to their personal friends at the expense of their shareholders. Take as an example two wholesale houses, one owned and managed by a single merchant, the other owned by a joint stock company and managed by a paid employee of the company. Then suppose a third man, well known to both the owner of the first store and the manager of the second, approaches both these men to ask for credit for his retail store. The first merchant, owning his own business, may feel that he can afford to oblige an old friend, even if the security for repayment appears to him insufficient; the loss, if loss is incurred, will fall on himself alone, and no one else has the right to call him to account. The mere manager, on the other hand, cannot afford to take any chances; he is paid to look after the interests of his shareholders, and every business act of his should be able to stand their closest scrutiny. If he neglects the interests of his employers—the shareholders—in order to serve his friends, he betrays the confidence reposed in him, and deserves to be summarily dismissed. This rule of conduct is now being more and more stringently observed, so that modern business is transacted in much more strictly economic fashion than that of former times.

The Meaning of Wealth.

Political Economy is, we have said, the science of wealth. Now what do we mean by "wealth?" Wealth is all that which has value in exchange. The economist is not concerned with all valuable things or with all useful things, but only with commodities which, owing to a limitation in their quantity or a difficulty in their attainment, have a value in exchange which can be measured by price. Such commodities as water, since they exist in such abundance that all men may, under ordinary circumstances, have all they want for nothing, have practically no value in exchange, though they have a value in use. Anything which possesses value in use may, under certain circumstances, have a value in exchange. Water may be so scarce in the Sahara desert or air in a submarine boat that people would be willing to pay very highly for it.

Wealth may be either material or immaterial. Material wealth includes not only houses, lands and furniture, but also shares and mortgages—since these represent a part ownership of property. For instance, a $100 share in a Canadian chartered bank with a capital of $1,000,000 represents one ten-thousandth part of all the real estate, etc., in the possession of the bank. An example of immaterial wealth may be found in the sale of the goodwill of a business or of a doctor's practice, which, although quite intangible, have often a very considerable value in exchange.

Besides these two kinds of wealth, we have also what is known as quasi-wealth. By this, we mean the untransferable skill of the workman or the professional man,—capacity residing in a living person and arising from the fact that his proficiency in some line of effort enables him to produce values in exchange which other men cannot produce. This quasi-wealth may be described as the capitalized value of the skill of the workman or of the professional man. It cannot be transferred, but its kinship to wealth is established by the fact that its products—its results—are transferable. One man, we will say, reaches the age of twenty-one an unskilled laborer—having had no special training in any useful line of activity; another man, at the same age, has a thoroughly good business training or a university degree. The first may be worth to his employer $500 a year; the second $1,200. No one would doubt that the second man is, on the whole, wealthier than his neighbor, even if he had not a cent to his credit on his twenty-first birthday, while his rival had some hundreds or even a thousand dollars in the savings bank. The first man had put his $1,000 out at interest and drew 3% on it; the second had invested it in developing his brains, recognizing the fact that brains pay a higher dividend than 3%. The skilled farmers who are now flocking in such numbers into our Northwest would be a great asset to the country even if they did not bring a cent of money with them. Their scientific training and skill, though not themselves wealth, are in the highest degree productive of wealth, and thus they make the country richer.

Value and Price.

Value is a word derived from the Latin verb **valere,** to be strong or powerful. When we say, therefore, that wealth is all that which has value in exchange, we really mean all that which has power in exchange—the things a person possesses that are desired by other people, who are consequently willing to give him the things he desires in return for them. The value of one thing in terms of another at any place and time, is the amount of the second thing which can be got there and then in exchange for the first. We might say, for example, that two cows are worth one horse, if we can get a horse in exchange for them. The difficulty about an assertion like this is that one horse is different from another; and whereas a certain horse might be worth only one cow, a certain other horse might be worth ten cows. And so too with the cows; one cow might be more valuable and another less valuable than the average, and so it might be worth more or less than half a horse. And, further, it may be that though I have two cows to dispose of, a horse may be of no use to me. What I need is to be able to exchange my cows for something of invariable quality and great desirability which I shall be able to exchange for anything that I may happen to want. This something which is invariable in quality and in exchange for which I can obtain anything I wish, is usually called money, or the medium of exchange. Suppose I have a horse and want sheep in exchange for it, I do not have to go hunting around for a man who has sheep which he desires to exchange for a horse. That might cause a great waste of time. I simply sell my horse to the first man I meet who is ready to give me a fair money equivalent for it, and then use the money to buy sheep from the first man who offers them for sale on terms that suit me. The money I got for the horse has been the medium of exchange which allowed me to secure the sheep or whatever else I needed.

The value of a commodity as expressed in terms of money is called its price. Money is used to-day in practically all the countries of the world as a medium of exchange, because it saves time, as compared with the old process of exchangeing directly the commodity one had for the commodity one wanted. This older process was known as barter. To-day money is used almost everywhere and the money that is used is nearly always either gold or, like our Dominion notes or silver, representative of gold. Now pure gold is a chemical element, and therefore a certain quantity of gold is always worth precisely the same as any other equal quantity of gold. Thus by using gold we get over the difficulty of the varying usefulness of different cows and horses.

Value depends partly on usefulness, partly on scarcity, Usefulness or utility will not in itself make an article valuable, for no one will pay for what is so abundant that he can get it for nothing. Scarcity alone will not make an article valuable, for no one will pay for an article which is of no use to him. Along with usefulness and scarcity an article must of course possess transferability to be valuable in exchange.

Utility or usefulness is an important word which is liable to be misunderstood by the beginner. He must remember that the economist can make no attempt to distinguish between the useful and the ornamental. All that man desires for any purpose has, from the economic point of view, utility, though it be a postage stamp collection, a picture gallery, or an automobile. All that a man desires has for that man utility. It has utility from the point of view of the economist who is watching that man's actions.

The value of a crop, however, does not depend only on its utility. Suppose that in 1910 there was a scanty wheat crop and wheat was consequently sold at $1.00 a bushel, while in 1911 an abundant wheat crop brought down the price of wheat to 75 cents. Now a bushel of wheat in 1911 has just the same utility for the support of human life as in 1910. Why then should it be cheaper? Simply because there is so much wheat on the market that the buyers feel that they can readily obtain, at a low price, all the wheat they want, while the sellers are forced to dispose of their wheat in order to purchase the other commodities of which they have need. In years of abundance the whole country is like a small boy at a fair, who has almost satisfied his desire for food and will not now pay nearly so much for additional food as he would have paid for precisely the same eatables when he was hungry.

Law of Diminishing Utility, Consumer's Surplus.

This example brings us face to face with one of the greatest laws of economics and of human nature. It is known as the law of diminishing utility, and may be briefly stated as follows:—the value of any additional quantity of an article to a consumer decreases with every increase in the stock of that commodity he already has. For only a certain amount of any commodity will a man pay the market price. Beyond this limit he will buy only at what he considers bargain prices. The last amount for which he will give the market price of the moment is called his **marginal purchase**, and the utility of this marginal purchase to him is described as the **marginal utility**.

Suppose a small boy is on a train and arrives at a railway station where there is only one seller of food. The caterer notices the boy's eyes fixed greedily on the ham sandwiches. The youngster asks the price of a sandwich and is told "25 cents." He protests that this is robbery, but the seller is inexorable, and at last he pays the 25 cents for the first sandwich. This takes the edge off his appetite, and when the caterer asks him if he wants another sandwich at the same price, he will refuse. However, if the caterer brings the price down to 20 cents, he may buy. Similarly, he may be willing to pay 15 cents for a third, 10 cents for a fourth, and 5 cents for a fifth sandwich, but may decline to pay even 5 cents for a sixth. The first sandwich is his marginal purchase when the price is 25 cents, the second when it is 20 cents, and so on down to the fifth sandwich, which is the marginal purchase when the price is 5 cents. The utility of each successive sandwich to the boy is measured by the price which he is willing to pay for it.

Now in actual fact this scene is rather unlikely to have occurred. The sandwiches were probably on the lunch counter plainly marked "5 cents each," and the boy paid 5 cents for his first sandwich just as he paid 5 cents for his fifth. He would decline to pay 5 cents for a sixth, just as he did in our hypothetical case· That is, the purchase of the fifth for 5 cents would still be the marginal purchase. Thus he got 5 sandwiches for 5 x 5 cents, instead of for 25+20+15+10+5, or 75 cents. In other words, he got out of his sandwiches for which he actually paid 25 cents enjoyment for which he would have been willing to pay 75 cents . That is, the total utility of the sandwiches to the boy is measured by 75 cents. The difference of 50 cents is what Marshall calls **consumer's surplus**—the difference between what the consumer would have been willing to pay for the various unit quantities of the commodities consumed and the amount which he actually did pay for them at their market price. One can easily prove by reference to one's own experience as a purchaser the existence of a consumer's surplus.

How Demand is Regulated.

Statisticians are fond of reckoning the total amount of a certain commodity consumed in Canada, and then dividing that total by the number of the people in the country, thus finding out how much tea or sugar or bread the average Canadian consumes. Suppose that we begin our calculation of demand with this average Canadian and say that he will consume 1 pound of tea a year when the price of tea is $2 a pound, 2 pounds if he can get it for $1.50 a pound, 4 pounds if he can get it for $1.00 a pound, and, say, 10 pounds if he can get it for 50 cents a pound. In other words, if the market price of tea were 50 cents, he would be willing to buy 10 pounds, but he would not pay 50 cents for the eleventh pound, because, owing to the law of diminishing utility, the amount of pleasure given him by that eleventh pound of tea would not be worth to him 50 cents.

We have assumed that this man is an average Canadian. Then, if the population is 8,000,000, the amount of tea sold in Canada will be 8,000,000 pounds if the price is $2 a pound, 16,000,000 if the price is $1.50, 32,000,000 if $1, 80,000,000 if the price is 50 cents. Assuming that at the different prices the demand* for tea is as we have indicated, we notice that as price decreases the demand for tea increases; or, in other words, the larger the amount of tea or any other commodity which has to be sold in Canada in a given time, the lower will the price have to be in order that it may be disposed of. A merchant overstocked with fruit on Saturday night, often sells at a considerable loss for fear that at ordinary prices much of his fruit would be left on his hands and would be a total loss. On such occasions there is no limit to the price to which the article may drop, only temporarily, of course, since on the whole of his sales during the year the average fruiterer must make enough to live, else he would not remain in the business. But though prices vary greatly on such perishable commodities as fruit, the variation is comparatively little on more stable articles. When the market for these is glutted and the sellers cannot realize a fair price for them, they simply store them and wait until the market absorbs the surplus goods and recovers its equilibrium. Sometimes, however, the seller needs the money he has locked up in his goods, and has to sacrifice them at an excessively low figure.

So much, then, for the demand side—the side of the consumer—in the market. Now let us look briefly at the supply side—that of the producer.

How Supply is Regulated.

When a man produces, he is producing utilities, not matter—that is, he is making things more useful to mankind than they were before, as in the case of a tree turned into tables and chairs, etc. In return for the labour involved in doing this, he must receive at least his cost of production, not necessarily on every article he makes, but on his whole product. If producers of that particular commodity are scarce and at the same time there is a great demand for it, he will probably receive a great deal more than his cost of production. This was the case with the bicycle makers about fifteen years ago and with the automobile makers a year or two ago. But this leads producers in other lines to give up their trades and go into this; the final result is that production in this line expands to meet the demand and profits decline. If, on the other hand, producers of the commodity are many in number and demand for it is at a low ebb, the producer's reward tends to go even below his cost of production. Then some of the producers go into other work, the quantity of the commodity produced decreases, and consequently the producers are once more able to get a price equal to or greater than the cost of production.

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*The demand mentioned here is what the economist sometimes calls efficient demand—that is demand backed by the wherewithal in money or goods to exchange for the goods desired. A person's mere desire for an article cannot have any effect on the market for that article unless he has the money to pay for it.

It is, indeed, a commonplace of political economy that profits in all trades tend to a uniform level for men of about the same grade of ability, because men are always looking out for an opportunity of going into a highly remunerative occupation, such as auto-building, and any occupation which pays unusually high profits will probably attract so many other producers that in course of time the market will be over-stocked in a highly skilled trade. However, the first producers will for some time have a practical monopoly of the production, because it will take other producers years of effort to get a large body of trained men working harmoniously together to produce their wares. It will take years of advertising to build up a reputation for the new-comers' goods in opposition to the established reputation of the old. Thus the first men in the field have, in all probability, amassed a fortune during the period when they were the only producers. The makers of important patented articles are in a somewhat similar position. They are monopolists who can charge what they please for their products, but will certainly not charge so much as to discourage people from buying them.

Price Decided by Supply and Demand.

The market price of an article is decided by the equilibrium between supply and demand. It must approximate to the figure at which the demand of the consumer is sufficient to absorb all of the product. On the other hand, market price tends to react upon supply and demand. The most ordinary instance of this is when farmers give up producing a certain crop which has been selling at unremunerative prices. This commonly causes a scarcity of that particular crop, with higher prices, and it is said that farmers of greater than ordinary shrewdness will often continue to plant that crop in the expectation of this result.

N.B.—The next lesson will deal with production. In order that they may be able to understand it, students are particularly requested to make themselves thoroughly familiar with the economic terms used above. While the lessons are complete in themselves, students may for supplementary reading, refer to Seligman's Principles of Economics, part 1, chap. 1, and part 3, chap. 1; to Marshall's Economics of Industry, book 1, chap. 1, and book 2; also to Gide's Principles of Political Economy, book 2.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON I

Directions to Students.

Under the heading "Examination Questions" is a series of test questions which are to be fully answered and sent in to our Instruction Department for correction and criticism. You are requested not to answer these questions until you have thoroughly mastered the contents of the lessons on which they are given.

After mastering the contents of the lesson and studying each question thoroughly, write out your answers to all the questions as far as possible without referring to the subject matter of the lesson. In fact, we would strongly advise you under no circumstances to refer to the subject of the lesson when once you have set about to write your answers.

You will find it a good plan after you have written out your answers to check over your work in order to detect any errors, then re-write your answers, using pen and ink, and being very careful of your penmanship, spelling and composition.

Prepare paper for sending in as follows: Leave a margin of one inch at left edge of paper, rule a vertical line for this margin in red ink. Number your questions consecutively in this margin. Leave two lines blank after each solution. Write on one side of the paper only, numbering each page at the top in the right hand corner. In the left hand corner of the first page place your name, address and class letter and number, and in the centre of the page begin your lesson as follows:

Answers to Examination Questions.
Economics.
Lesson 1.

FOLLOW THIS PLAN IN ALL SUBSEQUENT LESSONS.

1. What purpose does our transportation system serve in modern times?

2. What would you consider the main points of difference between the savage and the civilized man?

3. What reasons have we for hoping that the comforts and the wealth of the masses of humanity will be increased as time goes on?

4. How are the nations of to-day attempting to better the condition of their poorer classes?

5. How far is the average man a "money-making animal" an "economic man"? Is he tending to become more so? Why?

6. What is wealth? Would you say that friendships are wealth? Discuss.

7. What is meant by quasi-wealth?

8. How does the use of money facilitate the process of exchange?

9. On what two things does value depend? Are the Socialists wrong in saying that the value of an article always depends upon the amount of labour it took to make it?

10. What do we mean by diminishing utility and consumer's surplus? Illustrate from your own experience.

11. What do we mean by **market price**, and how is it decided?

12. Explain the terms **supply** and **demand** in their economic significance.

ECONOMICS

LESSON 2

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ECONOMICS

LESSON II

Production

WE have already defined Political Economy as the science of the production, distribution and consumption of wealth. It has, therefore, three great departments. Of these three, production is naturally the first to be considered. In point of time, at least, it must precede distribution and consumption.

Production may be defined as the creation by mankind of values or utilities (those utilities which are created by man are limited in quantity, and thus always possess value). These values or utilities may be created in a number of different ways.

In the first place, production may consist of a re-arrangement of particles of matter, resulting in the creation of what some economists call **form-utilities.** This kind of production takes place in the case of agricultural products, where the particles of matter which were useless to man as long as they remained in the soil, become useful to him when they are transformed into plant tissue and are thus rendered available for food. So, too, a form-utility is created when useless ore is changed into useful metal by smelting.

Secondly, production may consist of a transfering of matter from place to place, or what we may call the creation of **place utilities.** An instance of this is found in the transportation from the Niagara Peninsula to Toronto and other cities of surplus fruit which would otherwise rot uselessly upon the ground. The creation of place-utilities occurs whenever farm produce is increased in value by transportation to the cities, or whenever manufactured articles are increased in value by transportation from the city to the farm. All our transportation agencies, railway companies, street car companies, express companies, etc., are engaged in the creation of place-utilities. These companies employ a considerable portion of the working population of the country, and these workers are just as much producers as are the agriculturists who actually raise the fruit or other products on their farms.

Next, production may take the shape of the creation of **time-utilities.** These come into existence whenever some perishable article which is of little or no value at some times in the year is artificially stored away and preserved until it becomes scarce and in much demand, and consequently acquires a high value. The most familiar instance of this is the case of the ice-harvest. The ice is cut when it possesses little or no value, preserved artificially, and sold at a time of year when it is scarce and possesses great utility and consequently considerable value. The cold storage plants for keeping meat, butter, eggs and other perishable commodities in good marketable condition, are another instance of production by the creation of time-utilities.

Lastly, production may take yet another form—the creation of **possession-utilities**—the transfering of goods from a person to whom they are of little utility to some one else in whose eyes these same articles have a greater utility. The grocer who sells vegetables is just as much a producer as the farmer or market-gardener who grew them, since he creates a possession-utility by transfering these goods to the person to whom they have greatest utility—the ultimate consumer.

It is necessary, therefore, for the student to rid himself of the popular idea that only the farmer, the lumberman, the miner and the fisherman, the men engaged in producing directly from nature, in so-called primary production, are actually producers. In reality the manufacturer who produces form-utilities, the railway man who produces place-utilities, the cold-storage man who produces time-utilities, and the merchant who produces possession-utilities are just as truly producers, and their services are just as essential to the well-being of society as those of the agriculturists. A strike of all those employed in transportation would be just as disastrous to the community at large as a strike of all agriculturists.

But what about professional men—the doctor, teacher, preacher, lawyer, etc.? They are not, strictly speaking, producers, because they do not produce any exchangeable utilities. Their mission is on a different plane from the economic. It is primarily to perform services of different kinds for the man himself, rather than to produce articles for his consumption. These services will probably tend to increase the productive power of the persons for whom they are performed, and may thus be said to be productive in an indirect and secondary way—**quasi-productive.** But this increase of the productive power of the doctor's patient or the teacher's pupil or the pastor's parishioner is only incidental, and is not the main object of the healing or the teaching or the preaching. Consequently the doctor, the teacher and the preacher are not primarily, though they may be and usually are, incidentally producers—not of wealth, but of the quasi-wealth residing in the persons of their patients or pupils or parishioners.

Production Never the Creation of Matter

It must always be remembered that no human being can create matter. Matter, the physicists tell us, is indestructible; the total amount of matter in the universe is a constant quantity; it can neither be increased nor diminished. All that man can do is (1) to change the form of matter—form utility; (2) to change the position of matter—place utility; (3) to keep matter in the same condition when it would naturally be changing—time utility; (4) to transfer the possession and ownership of matter from the person to whom it is less useful to the person to whom it is more useful—possession utility. In all of these ways matter may be made more useful to man; its latent possibilities of doing service to man are "led forth" (Latin pro forth, ducere to lead), and thus "production" takes place.

Requisites of Production

There are at least two things absolutely necessary to production—first, matter upon which to work; second, man's labour force working upon that matter, and bringing it into a more useful form. But that labour force needs to be supplied with tools and sustained by food in order to produce most efficiently, so that we may say that something else than matter and labour is required in the higher branches of production at least. The first two requisites of production—called primary requisites—are generally known to economists as land and labour; the last mentioned requisite—secondary requisite—necessary for all but the most primitive kinds of production, is known as capital, which may be defined as the product of past labour used to subserve the process of future production.

Capital must not be confounded with money, which is only the medium by which capital is transferred from hand to hand. Money of itself cannot aid in production, and has therefore no claim to share in the product. If you put $1000 in a manufacturer's safe, while forbidding him to use the money in his business, he will not be able to pay you interest on it. If you loan him the money to use in his business, e.g., in buying new machinery, paying wages, he will be ready to pay you interest on it. Your loan of the money transferred to him the purchasing power which the possession of that money gave to you. You waived your claim in favour of the manufacturer, who was consequently able to employ in reproductive ways the commodities purchased with your money, and could thus afford to return you your money with interest at the end of the year. You really loaned him purchasing power, and at the end of the period he was able to return to you a greater purchasing power because of the profit he had made by means of the purchasing power that you had lent him.

Each of these three requisites of production—land, labour and capital—deserves careful study from anyone who aspires to a knowledge of economics. In the first place, let us consider the various facilities which nature provides for the carrying on of production. These are included under the general term Land.

Land

These facilities consist primarily of land and water, the former of which produces the great bulk of food products and minerals, while the latter affords by far the cheapest means of transportation. It also produces an important part of the world's food supply in the shape of fish. Some day, when its resources of animal and plant life become more necessary to mankind on account of the increasing population of the world, its possibilities will no doubt be exploited, and the sea may conceivably become the greatest source of the world's food supply, as Jules Verne foretold in "Twenty Thousand Leagues Under the Sea."

Secondly, the term land includes the motive powers used by the manufacturer, for instance coal and water-power. For a manufacturing country, an abundant supply of good coal, such as exists in England, or an abundant supply of available water-power, such as exists in Canada, is an asset of incalculable importance, enabling these countries to undersell competitors who have no such cheap and abundant motive power.

The economic term "land" includes, therefore, all that is ordinarily meant by "natural resources." Now the prosperity of our nation or any other depends very largely upon the amount of production made possible by the natural resources of the country—its forest, agricultural and mineral wealth, its fisheries, and its coal and water-power. National greatness must be based on economic prosperity, and the first requisite for economic prosperity is a generous outfit from nature. Let us, then, consider briefly the natural resources of Canada, taking stock, as it were, of our national estate.

Agricultural Possibilities

Canada is one of the largest countries in the world, and although a large part of its territory is too far north to be of much use for agriculture under present conditions,* there still remains an enormous area available for the agriculturist.

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* Note—We say "under present conditions." It is absolutely impossible even to conjecture how greatly the productive area may be extended and the yield increased by the scientific breeding of plants on the principles discovered by the Abbé Mendel, and now universally accepted by scientists.

Of the vast area of the Dominion a comparatively small portion—roughly 100,000 square miles, or 3% of the whole —was occupied in 1901, and rather less than half of this improved. The land under crop, which amounted in 1901 to 19,763,000 acres, in 1909 had increased to 30,065,000 acres, an increase of 52% in eight years. The agricultural product in 1909 had an estimated value of $533,000,000 in field crops alone, or about $17.50 an acre.

Although this yield is a large one, nothing can be clearer than that Canadian agriculture is still in its infancy and may be enormously increased when the working population of the country is increased, and electric power applied in agriculture as well as in factory industry.

Forest Wealth

The forest lands of Canada have been estimated to cover a total area of 1,250,000 square miles ; another estimate gives the amount of merchantable timber in a small fraction of the total forest area as 192,000 million feet. On the other hand, Dr. Fernow, the head of the Faculty of Forestry of the University of Toronto, says the commercially valuable forest land is less than 500,000 square miles.

The actual value of forest products was estimated at $112,000,000 in 1909 and is still increasing. By a careful conservation of our forest resources such as is now being agitated for, we may expect that our forests may be made to yield considerable permanent net returns to the state as they do in European countries. It is most important to the whole country from the physical point of view also that large forest areas be maintained, because of the beneficial effects of the forest upon the temperature, rainfall, and drainage of the country.

Fisheries

The value of the Canadian fisheries has within the past few years averaged about $25,000,000 annually. This will no doubt be increased when the fisheries of Hudson's Bay and the northern gulfs and inlets are more systematically developed.

Minerals

The mineral wealth of Canada is incalculable. If the student will refer to maps 6 and 7 in the Atlas of Canada, published by the Dept. of the Interior in 1906, he will realize how small a portion of the Dominion can yet be said to be scientifically surveyed. Yet these maps show an enormous coal area surveyed (65,000 square miles in Alberta, and smaller areas in British Columbia, Nova Scotia, New Brunswick and Saskatchewan). Iron ore is mined in Nova Scotia, copper in Ontario, gold in Nova Scotia, Ontario, British Columbia, and the Yukon; silver in Ontario; nickel (of which the Dominion has a monopoly in America) in the Sudbury district of Ontario. The mineral production has been rapidly increasing from 10½ millions in 1886, to 49½ millions in 1899, 60⅓ millions in 1904, 80½ millions in 1906, 90½ millions in 1909, 105 millions in 1910.

Coal and Water Powers

The development of the different coal deposits and the abundant water power are in Canada, as in other nations, greatly increasing the production of manufacturers. Canada, backed by her enormous water power, bids fair to become a first-class manufacturing nation as soon as she has sufficient labour at command. Her available water power is officially estimated at 25,692,000 horse power, less than 2% of which is developed. This difference between the possible and the actual water power in use makes one feel that the country is still at a very early stage of its industrial development.

The growth of these manufactures may be indicated briefly by the census returns, although these do not furnish a proper basis of comparison, owing to the fact that the regulations governing the census-takers were different in the various enumerations. In 1871 the value of manufactured products was $221,600,000; 1881, $309,676,000; 1891, $469,850,000; 1901, $481,050,000; 1906, $718,352,000. It has recently been stated that the production of the members of the Canadian Manufacturer's Association alone will reach $1,200,000,000 in the year 1911.

Labour

No matter how great the natural resources of a nation may be, they are of little avail to increase its positive riches until they have been exploited by man*. They resemble the tools in the workman's hand, which are of great assistance in enabling him to produce what he could not otherwise produce so well, but are quite useless without him. These natural resources are not wealth in themselves any more than is a man's power to labour when he is unable to obtain work. For wealth to be produced, it is necessary that man's labour be applied to the natural resources.

Labour is defined as effort, bodily or mental, put forth by human beings, not exclusively for the sake of the pleasure immediately associated therewith, but partly or wholly with a view to the attainment of some ulterior object.

Labour as stated in our definition includes both mental and physical effort, though in ordinary language "labour" refers usually only to physical toil. In economics the cabinet minister and the college president are labourers, because their efforts enable men to produce to better advantage than formerly. The cabinet minister aids production by administering the law justly and securing to each his own property—a great stimulus to hard work. The college president is a labourer, because his is the task of finding out and putting into operation the curriculum best suited to the needs of his students. If he has been able to gauge correctly the demands which society will be likely to make on his graduates and to produce men who will measure up to those demands, he will have rendered a very real service to the community. Perhaps no one is ultimately more productive than the man engaged in developing the physical and mental qualities of mankind, though from the strict economic point of view he is only quasi-productive, because he produces only quasi-wealth.

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*Note—The student may illustrate this by comparing (let us say) the area included in Canada and the United States of 1610 with the Canada and United States of 1910. In 1610 these enormous countries had even greater natural resources than at present; yet they afforded only a miserable subsistence to 1,000,000 Indians, as compared with the ample provision which they make to-day for a population one hundred times as great.

Labour is performed, not for the sake of the mere performance itself, but for some ulterior end. Thus playing a game is not usually labour, but exercise in the gymnasium is. That is usually undertaken for the ulterior end of preserving one's health. In the game on the other hand, one forgets that he has a body to develop, and simply enjoys himself.

The ulterior end of labour is the production of utilities wherewith the worker may secure other commodities sufficient for his support and that of those dependent upon him. Labour in itself is irksome, but its irksomeness is borne because of the advantages which accrue from it to the worker. The utility of the commodities to the worker outweighs, up to a certain point, the disutility of the labour. But in every process of production a time will come when the worker's weariness is such that the disutility of the labour will outweigh the utility of the commodities gained by his labour. Then, if he is free to do so, the worker will cease to labour.

The complete body of the producers of a country—agriculturists, transportation men, manufacturers, merchants, etc.—may be described from the economic point of view as the labour force of the country. Wealth is produced by the labour force of a country acting upon the natural resources of that country. The amount of wealth which can be produced will depend largely upon the amount of that labour force, its intelligence, its technical skill and the organising ability of those who are in control of it, as well as upon the motive power and facilities of transportation, etc., afforded by the natural resources of the country. As natural resources are a constant or even a decreasing quantity, we must increase our labour force in numbers, strengthen it in intelligence and technical skill and improve its organization, in order to effect an increase in its product. As in a new and thinly-settled country like our own, natural increase is not sufficient to provide for the development of the country, it is necessary to encourage immigration, in order that the wealth of the country may be increased by increasing the number of its producers.

Let us consider briefly the labour force of our own country. The actual number of agriculturists in 1901 was 545,000 with 73,000 wage earners or hired men. The agricultural labour force was thus according to the statistics 618,000 persons (the farmer's sons and daughters living and working at home apparently not included). The product in 1901 was, according to the census figures, $364,900,000, and in 1909 was estimated at $700,000,000. In manufactures in 1901, 276,000 were employed with a total product of $481,000,000 ; in 1906, 356,000, with value of products $718,350,000, an increase of 29% in the number of the wage earners and of 49% in the value of the products. To put it another way, the average wage earner produced in 1901, $1,535 ; in 1906, $2,018. While the number of wage earners was rapidly increasing the skill of the average wage earner was also increasing. The census of 1911 will doubtless show a large increase in the number of wage earners, and a considerable increase in the product of the average wage earner. This increase is due to two things ; increased technical skill and better organization. It, like all other increases in monetary values during the same period, is to some extent apparent rather than real, on account of the higher prices prevailing in 1911 than in 1901.

Capital

The amount of product, however, does not depend alone upon natural resources and human labour. Let us illustrate this from the case of Robinson Crusoe. Suppose he had landed on the desert island without tools of any kind—without axes, guns, seeds, food, or even a pocket-knife. What would have been the result? He could not have got along nearly so well as (in the book) he actually did. He might have starved to death. In any case, though the natural resources of the island might be the same, and the qualities of the individual man Robinson Crusoe the same, yet his production of wealth would be much less, on account of his lack of tools, seeds and food. With these, he could make a clearing, plant his seed, and wait for harvest ; without them, he could only pick up a precarious living by trying to catch shell-fish—sometimes succeeding, more often failing in his efforts. Novelists who want to represent their heroes as wrecked on desert islands, therefore, nearly always arrange for food, seeds, boxes of tools, clothes, etc., to be washed on shore from the wreck. These become the means by which the hero civilizes the island and its inhabitants, so that in the end we have a civilized and prosperous settlement.

A group of men, then—a little colony newly established—naturally requires help from older and wealthier nations. Thus the United Empire Loyalists, on coming from the States after much of their property had been confiscated, found themselves unable to cope unaided with the rigours of the Canadian climate, and were maintained for the first year or two of their residence in this country by the British Government, which appropriated over $15,000,000 for the purpose of supporting the exiles and providing them with seed, so that they should be able to clear the forest and raise crops of their own.

This is a universal experience. In order to produce effectively, it is necessary that the producer shall be provided with tools and with subsistence until his product is realized. These are his capital, which we may define as the product of past industry applied to the work of subserving future production. A young man, we will say, works on a farm for several years after he reaches the age of twenty-one, saves $1,000, then goes west and takes up a homestead. In such a case, he has practically the whole of the $1,000 as his capital invested in his new venture; he buys horses and implements with it and puts up a shack. By the aid of this $1,000 he finds himself in a vastly more advantageous position than are those of his competitors who try to begin farming without a cent. Because he has better tools and is in no immediate need of the necessities of life, he can produce more than the man who has a smaller capital. In fact, the latter will, if he can, borrow money in order to use it in his business. It brings him so many advantages, that he is glad to pay 6% or even 8% interest for it. $500 spent judiciously in machinery and tools will be worth more to him than $30 a year—the interest on $500 at 6%.

Nations are just like individuals in regard to the possession or non-possession of wealth, The old, long established nations, are wealthy ; they are able to provide all the capital required to develop their own industries and, in addition, to lend to other countries. On the other hand, the newer countries of larger area are unable to save enough capital from current consumption to develop their resources. Capital is, therefore, scarce and dear among them ; the rate of interest is high, just as in our North West the rate of interest on farm mortgages is higher than in Ontario, because there is so much less capital there seeking investment, and so much greater a demand for it to assist in developing the country. So too in Ontario and Eastern Canada, capital is scarcer than in England, is more in demand, and thus bears a higher rate of interest. The West is poorer than the East, and the East is poorer than England, just as the young man who has but lately begun to earn his own living and has had but little time to save, is poorer than his father, who has been saving throughout his life.

Canada, then, is poorer than England—perhaps not per capita, but absolutely. Canadians have a great undeveloped estate, and they are, as we have seen, bringing in hundreds of thousands of people of every nationality to develop their natural resources. These people, however, must be maintained during the long period before the benefits of their labour begin to be realized. Canada has to borrow a great deal of the capital required to maintain them and to provide them with the tools necessary for efficient production. Our federal, provincial and municipal authorities, our railway and street car companies, and our manufacturing enterprises go very largely to other countries to borrow the money necessary for the development of Canadian resources. This procedure tends to lower the rate of interest in Canada, because the imported capital comes more or less into competition with that which is saved within the country itself ; it tends to increase the interest rate in England, because some of the extra supply is taken away from the English money market. Economists think that the rate of interest tends gradually to approach an approximate equality in enterprises of equal stability the world over. Wherever the laws of a borrowing state are just and fair to a foreign creditor, the capitalist will probably invest, not caring where his capital is employed, but studying only how to combine the most perfect security with the highest rate of interest.

The greatest lender of capital in the world is Britain. Her comparatively small area has been fairly thoroughly developed, and the greater part of the capital annually saved by her people goes abroad for investment in foreign countries and British possessions. Consequently we find the British people keenly interested in the affairs of every country of the world, since British creditors have capital invested in them all. France occupies second place as an investing nation, largely on account of the saving habits of her people. The United States too are beginning to invest a good deal of capital abroad, a large part of which has come to Canada.

This country has, within the past few years assumed a rapidly increasing prominence as a field for investment. The stability of its government, the essential justice of its laws, combined with its great natural resources and its nearness (as compared with the other great new countries, such as Argentina, Brazil, South Africa, and Australia) to the markets of Europe and the United States, have caused it to be regarded as a most desirable country for investment. European and American investors can easily come over and see the properties in which their money is involved. British and foreign investment in Canada has, therefore, been rapidly increasing. Investments are made in our national and provincial debts, in our municipal debentures, in our railway and industrial stocks. (The president of the G.T.R. was lately responsible for the statement that not $1,000 of the stock was held in Canada. In a hundred other enterprises the same or nearly the same thing is true.)

The total amount of British and foreign capital invested in Canada up to April, 1911, has been estimated by Mr. F. W. Field of the Monetary Times at $2,416,000,000. Of this enormous sum, Great Britain alone has supplied more than three quarters — $1,860,000,000. Americans have invested $417,000,000 in this country, Frenchmen $78,000,000, Germans $33,000,000, and the citizens of various other European States from $25,000,000 to $30,000,000.

If the average rate of interest paid on these outside investments is 5%, then Canada pays annually to her British and foreign creditors, interest amounting to about $121,000,000,—a sum greater than the total annual revenue of the country, and a heavy burden for a population estimated at 7,150,000, amounting to over $85 annually for each family of five. The reason for our having incurred such a heavy liability is simply that our gain from the development of our country is so enormous that we are able to pay this vast sum as interest and still make a large profit for ourselves by means of the borrowed funds. Sooner or later our country will be so developed by the aid of this capital from outside, that we shall easily be able to pay off our foreign creditors, principal and interest.

Of course, besides all this outside capital, there is a great deal of native capital invested in the country. If I earn $1,500 a year and spend only $1,200, I save $300 a year. Now if I put that $300 to work to assist in future production, either in my own business or that of others, I will get a return for its use. If I put it into the savings department of a bank, the banker will loan it to the merchant or the manufacturer, who needs it in his business, paying me 3% on the money, and (in practice) allowing me to withdraw it at any time, so that it is almost as good as cash to me. If instead of putting it into a bank I prefer to invest in municipal or industrial bonds, I can get from 4% to 6% on my money. Or again I may prefer to invest my savings in real estate. No one can estimate how much capital Canadians have invested in Canada, but there is no doubt that it is rapidly increasing, though not, of course, so rapidly as to provide the funds required for the phenomenal development of the country. The deposits in the chartered banks have grown from $390,000,000 in 1902, to $825,000,000 at the end of 1910, more than doubling in eight years. Current loans in Canada increased in the same period from $303,000,000 to $677,000,000. These are about the only Canadian investments in Canada for which we have clear and definite statistics. It is quite impossible to give figures for

Canadian investments in other directions—in stock, real estate, etc., but there seems no room to doubt that these have grown at least as fast as have the bank deposits.

Perhaps no other country in the world, with the possible exception of Argentina, has shown an equal rate of increase in production during the past decade. Canadians are justly proud of this remarkable record, and are hopeful that the next decade will show even greater progress than the last. The enormous natural resources which still remain undeveloped, provide the raw material for a marvellous increase of production, but whether the glowing anticipations of today will be realized, depends on whether Canadians will be able to go on increasing their labour force in numbers (by natural increase or by immigration), while at the same time they do everything possible to improve its quality. They will also require to obtain either from Canadian or from foreign investors the capital necessary to enable their labour force to work to the best possible advantage.

N. B.—Students may, for supplementary reading, refer to Gide's Principles of Political Economy, book 1; Marshall's Economics of Industry, book 4 ; Seligman's Principles of Economics, chaps. 19-21. For the purpose of tracing the the growth of Canada, they would do well to secure the last issue of the Canada Year Book through their local M.P., and consult the various tables, especially those showing the increase in agriculture and manufactures and the increase in the population of the Northwest Provinces between 1901 and 1906. The latter figures may be compared with the census returns of 1911.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON 2.

1. How would you prove that the merchant is a producer?

2. Is the professional man a parasite upon society? Give reasons for your answer.

3. Is the banker a producer? What is his function in the process of production?

4. What are the requisites of production? Write a brief note on each of them.

5. Give a brief account of the natural resources of the Dominion.

6. Define "labour." Is a game of baseball labour? (1) To the amateur? (2) To the paid professional? (3) To the spectator? (4) To the journalist who is reporting the game? State the reasons for your answers.

7. Show by statistics that the productive efficiency of the average workman is on the increase.

8. What benefits does a young country receive from immigration? Are there any counterbalancing disadvantages?

9. What is capital? Distinguish between it and money. Would money have been capital to Robinson Crusoe? Would seeds?

10. Why are men ready to pay interest for the use of money?

11. Suggest reasons why British investments in Canada should be so much greater than foreign investments.

12. When you put your savings in a bank, what enables the banker to pay you interest on them?

ECONOMICS

LESSON 3

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ECONOMICS

LESSON III

Early Economic Development of Canada

IN the last lesson we considered first the natural resources of our country—the facilities for production which exist within its bounds. Then we dealt with the population by which these natural resources have been exploited. Thirdly, we considered the capital, whether produced within the country or without it, which has from time to time been invested in increasing the productive efficiency of the population.

Now we have to begin to trace the economic development of Canada from its first settlement to the present time. In the beginning we have the process of utilization of the country's resources, as it was begun by the early French settlers and the United Empire Loyalists who in turn were confronted with the necessity of satisfying the three elementary needs of life—food, clothes, shelter—unless they were to perish in the northern wilderness. Here the producer and the consumer were the same person—people produced for their own immediate needs to protect themselves and their families against famine and cold. Goods produced on a certain farm were consumed on the same farm, and there was no object in producing very much more than was necessary to maintain the family until the next harvest. To-day we produce surplus commodities to be exchanged in far-distant markets for articles which we desire but cannot produce at home.

The Fur Traders

The first Europeans to settle America came hither, not with the idea of performing hard manual labor, but with the object of achieving a more speedy wealth through the discovery of minerals or the exploitation of the fur trade. Some of them succeeded in their undertaking, but from the point of view of the economist as distinguished from that of the historian, the Hudson's Bay Company or the North West Company or the French Company of One Hundred Associates, though their history may be more romantic and though they were of real service to the country in making explorations, were far less important than the hardy French and English pioneer settlers who cut down the forests and gradually won wider and wider areas for civilization. We may illustrate the comparative unimportance of the fur trade to-day by the fact that out of a total export trade of over $300,000,000 in 1910, exports of furs were only $3,750.000, or 1¼%—one-eightieth of the whole. The fur trade was able to enrich a few individuals, or even chartered companies, but its returns were entirely inadequate to form the economic basis of a prosperous commonwealth. The first requisite for that is a large production of food. Civilization implies the aggregation of a considerable body of population such as can never exist in a country devoted to the rearing of wild animals whose furs may be sold. We may regard the fur traders, French and English alike, as comparatively insignificant factors in the economic development of Canada.

The Seigneuries

The king of France and the king of England, when they came to the problem of settling the new colonies, both adopted the same method of making large grants of land to aristocratic individuals on condition that they should agree to take out settlers from the mother country and establish them on parts of their new domain. Thus, although the progress of settlement in New France was at first very slow, settlements were finally established along the St. Lawrence, the Lower Ottawa and Richelieu Rivers. In 1712 there were 90 of these great feudal estates or seigneuries in French Canada. These became the first economic units. One seigneurie was economically almost independent of others, and consequently if we consider the economic life of one seigneurie, we shall have a very good picture of the economic life of all French Canada.

This seigneurie was an extension to this continent of the feudal institutions of Europe. The areas granted by the

French Government to French army officers varied greatly in size with the caprice of the monarch, but they averaged about half as large as our townships. The seigneurie of Beauport was, perhaps, smaller than most, but it will do to illustrate the institution. The Company of New France granted it to Robt. Giffard in 1634. The estate extended a league along the shore of the St. Lawrence by about 1½ leagues back from the river—altogether a nice little estate 8,000 or 9,000 acres, an area which was later increased to about 25,000 acres.

The conditions upon which such grants were usually made were, (1) that the seigneur should pay specified feudal dues to the king and be ready to take part in the defence of the country; (2) that he should place settlers in his seigneurie and encourage them to clear the lands, exacting only a small fixed rental and such other payments in kind as were considered seigneurial rights in France.

The seigneurie formed a practically self-sufficient economic unit. The seigneur at his manor-house was the head of the little society, farming a portion of the seigneurie, administering justice, and receiving from those to whom he had granted lands the recognized feudal dues: (1) the cens et rentes—a few cents for each arpent—192 feet—of frontage on the river with usually some fowls and a small quantity of grain, paid annually in the autumn on St. Martin's day, Nov. 11*; (2) the lods et ventes—1-12 of the price whenever the tenant sold his holding; (3) when the seigneur erected a grist-mill, the habitants were required to take their grist thither to be ground and to pay 1-14 of it to the seigneur as his toll; (4) the corvée—each seigneur had the right to a certain number of days' labor from each of his tenants—usually from three to six per annum; (5) often there were the droit de pêche and droit de chasse, the seigneur having the right to fish out of the waters and the right to hunt with hound and falcon over the cultivated lands of the people.

The curé or priest was the other great man of the seigneurie, and was supported by what are called the tithes —not really a tenth but a twenty-sixth of the cereal produce of the seigneurie or parish. Special levies were made on the habitants whenever any extraordinary expense, such as the building of a new church, was incurred.

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*Prof. Wrong in his interesting book "A Canadian Manor and its Seigneurs," estimates the "cens et rentes" on a 100 acre farm at $1.00 and a couple of chickens—certainly not a burdensome payment.

The Habitants

The inhabitants of the seigneurie (the habitants) lived along the river, which formed the chief highway of the district. Their farms were exceedingly narrow, because all wished to live on the river front. Many of them were only 2 arpents (384 ft.) in width by 40 arpents in length—a shape which, whatever its advantages, naturally retarded the cultivation of the back of the farm. The methods of cultivation were primitive ; manuring was rare, and the rotation of crops almost unknown. The short summers, with the frequent religious holidays and occasional bad weather, made it impossible for the habitant to give more than 90 days per annum to the cultivation of his land ; consequently he was unable to secure a large surplus crop. All the grain produced was needed for home consumption. In spite of continual wars, however, the colony progressed, and we are told that in 1749 more than 200,000 arpents of land had been cleared, supporting a population of 50,000. Wheat was the staple crop, but peas, oats, rye, and barley were also grown ; cabbage, pumpkins, and melons were produced in plenty. Some of the habitants had orchards ; others produced flax and hemp. The raising of horses and cattle was an important branch of husbandry, and the St. Lawrence meadows were considered to be superior to those of the English colonies. Fisheries and hunting also helped to provide food for the population. The habitant did not do badly when we consider the wars, the burdens of taxation and the seigneurial dues by which he was hindered in his efforts at improvement.

The habitant had not only to feed himself ; he had also to clothe himself. This he did partly by raising sheep and spinning the wool, partly by raising flax and converting its fibres into linen. Even in 1830 there were 13,400 domestic looms in Lower Canada, producing annually nearly

4,000,000 yards of woollen and linen cloth. The old spinning wheel which has now been relegated to our museums, was in every cottage, and the wife and unmarried daughters spent a large part of their time in making the clothes of the family. Thus the household and the seigneurie were sufficient unto themselves in the matter of clothing.

The same was the case with building. The manor-house was usually a spacious stone structure with large rooms and a specially large living-room with a great open fire-place, where the seigneur did business with his habitants. The habitants' houses were built of stone or rough-hewn timber, usually consisting of one story with low attic bedrooms. "Within were two or three large rooms, with low ceilings supported by beams—a living-room with fire-place, a kitchen with a large bake-oven, and often a ground-floor bed-room. Then at the rear there was a lean-to for a storeroom and at a short distance off, the barn and stables." All these were whitewashed, as is still the case in French Canada.

The habitant, then, lived a very simple life. His needs were few and these were practically all supplied from his own farm. He had little need of money except to pay the small annual rental to the seigneur and the taxes to the government. He was not oppressed. In 1798 the whole seigneurial revenue coming in to Colonel Nairne, the seigneur of Murray Bay, was not over £40—exclusive of the returns from his own farms included in the seigneurie.

The peculiarity which distinguishes the province of Quebec from the English-speaking provinces is its seigneurial tenure, which was, no doubt, on the whole a check to industry and progress. Yet we are not to suppose that no similar feudalism has ever existed in Upper Canada.

Here is a contract made by Archibald Macnab of Macnab township, a Scottish laird who emigrated to Canada in the twenties of the last century.

> I bind myself to locate you on the rear half of the sixteenth lot of the 11th concession of Macnab, free of any quit rent for three years, upon your thereafter paying to me, my heirs and successors forever, one

bushel of wheat for every cleared acre upon the same land."

Here we have practically the same thing as the "cens et rentes" of the French Canadian seigneur. Somewhat similar was the case of Col. Thos. Talbot who began a settlement in Elgin County on the shores of Lake Erie.

The United Empire Loyalists

Generally, however, the spirit of feudalism was not very apparent in the settlement of the province of Ontario, except for the fact that officers in the army received larger grants than others. When that settlement began about 1784, the emigrants from the United States—the United Empire Loyalists, as we call them—found themselves united by a common loyalty and a common destitution, as nearly all their properties had been confiscated by the authorities of the States from which they came. They were so many Robinson Crusoes, castaways in a country which, except for the forts at Cataraqui and Niagara, was an unbroken wilderness. The authorities at these places gave them a little flour and pork, a few hoes and axes, and they drew lots for the most desirable lands. They eked out their scanty provisions with fish and wildfowl.*

In the following year the settlers were better able to look after themselves. Each United Empire Loyalist received from the government 200 acres, tools of various kinds, seed-corn, etc. This came to them out of the $15,000,000 voted by the English government to compensate the United Empire Loyalists for their losses. By the winter of 1785 most of these early settlers had huts built, prepared to withstand the rigours of the climate. "The little log huts were raised in the middle of the clearings, supported by immense chimneys of rough stones, which opened in the dwarf interiors fire-places nearly as large as one side of the enclosure. The chinks in the logs were stuffed with moss and clay, and the stones were cemented by nothing stronger than the soil from which they had been gathered. Night and day fires were kept roaring in the hearths ; the precincts gradually widened in the snow as trees fell under the axe, and the interior of the cabins began to take on an air of rude comfort as, one by one, rough articles of furniture were knocked together by the light of the fire.'' *

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*The earliest settlers were aided only by the most necessary articles, made for them by the artificers of the regiments at Quebec and elsewhere. The later arrivals received the following tools and implements. To every six families, one cross-cut saw; to every family one hand saw, one hammer, two gimblets, ninety pounds of nails assorted, one set of door-hinges, one axe, one mattock, one spade, one scythe, one sickle, one set plough-irons, one set harrow-irons, one broad-axe, two augers, two chisels, one gouge, one drawing knife, one camp kettle.

The harvest of 1785 was gathered in with the sickle and the scythe, was threshed with flails, and winnowed, and finally the grain was crushed, usually in the hollow scooped in a hardwood stump—a rude kind of mortar. It is related that cannon-balls were frequently suspended by cords from the end of a pole which was balanced like a well-sweep and used to pound the grain into flour, for there were as yet no mills in the country.

Meanwhile the women of the family learned tanning from the Indians, spun thread from the fibres of the basswood bark, and made clothing of deerskin, trousers and smocks and petticoats such as would last for years, even amid the rough usage of their frontier life. Stockings were unknown, for there were no sheep and consequently no wool, but when it became possible to obtain leather, the men made shoes for their families. Handlooms and spinning wheels were also constructed during the winter, by means of which the women would be able to weave into cloth the prospective wool and flax which they hoped to raise. Kitchen utensils were carved out of wood—plates, bowls, spoons and forks, for ''necessity is the mother of invention,'' and the necessity of the newly-arrived colonists was great indeed.

The First Grist Mills

As settlement took place along lakes and streams, some water-power gradually became available for the grinding of the farmers' grain, and by degrees this method of grinding

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* Duncan C. Scott: Life of Sir John Graves Simcoe, page 62.

took the place of such clumsy processes as pounding the grain with a cannon-ball. After the little grain harvest had been gathered in and threshed, the settler carried it by boat along the lake shore or down the river until he reached the mill. There the miller ground it into flour for him, and, retaining 1-12 of the flour as his toll, sent the settler back with the remainder to his farm. The flour so milled, along with the inevitable pig, constituted the chief sustenance of the family during the long cold winter months.

The existence of a grist mill was thus a great convenience to the inhabitants of the new-made colony. The mills were often erected and operated by men who themselves owned and worked farms where water power happened to be available, and ran the mill only when customers appeared. The operation of the mill would naturally not interfere with the cultivation of their own farms, since the grain was usually not brought in until the season for continuous farm work was over. These mills, rude and defective as they often were, nevertheless were a great boon to the settlers, and mark a stage in the increasing division of labor. It was worth the farmer's while to make the often long and tedious journey to the mill in order to have his grain ground for him. If it had not been to his advantage he would not have done it. He could have gone on using a cannon-ball and a hollow stump, but it paid him better to spend his time in clearing his land and growing grain, and to leave the grinding of it to someone who had better implements and more experience than he had. That is precisely the reason for all the subsequent division of labor that we shall see going on. Whenever it is introduced, the reason for the introduction is simply that it pays.

But it takes place only when you can produce more than you want of some products and obtain the products of other men in exchange for your surplus. The troops constituted the best market for the farmer's surplus produce, especially as he had a practical monopoly of their custom. Prices accordingly were high. As early as 1793 the colonists of the Kingston district were able to produce $53,000 worth of surplus goods, mainly food-products—which they sold to the Lower Canadians or to the Government. A considerable number of troops were kept at Niagara and York, and these could be fed more cheaply from Kingston than from Lower Canada. The farmers began to accumulate a little money, and to be ashamed of their previous poverty, especially as many of them had been wealthy before the Revolution. Accordingly we have them buying cloth and furnishing employment to peripatetic tailors, who could make better clothes from the cloth which the farmer bought than the farmer's wife and daughter could. The shoemaker was often employed for similar reasons ; the rough shoemaking which the farmer had done for himself and his family on his first coming into the country was no longer necessary. Just as the providing of the clothing—at least the better sort of clothing — of the population became a specialized business, so also the business of building became specialized—was assigned to a definite class of men who spent their whole time at it. Also, as a natural result of the teaming of grain to market, a new class of men began to arise—blacksmiths on the country cross-roads, who could shoe a horse or mend a waggon. Sometimes these same blacksmiths themselves made the waggons, but that branch gradually began to develop into a full-fledged business by itself—another stage in the division of labour.

Professional services were obtained in very much the same way as those of the tailors and cobblers. The clergy of all denominations were more or less itinerant, going throughout the country holding services in kitchens or barns. The teacher, too, boarded round the section—one week at one house, two at another. Both he and the preacher received payment for their services largely in kind, for there was little money in the country. Both were on the whole ill-educated, as might be expected from their unsettled mode of life. A teacher of the higher type—brought out from Scotland—was the famous John Strachan, afterwards Bishop of Toronto.

Early Stores

But where did the farmer buy his cloth and the pedlars their wares? At quite an early period we find stores established along the Bay of Quinte and the St. Lawrence River, which bought the farmers' surplus products, sold them off in Lower Canada or at Niagara, and paid him for them in goods. (There was very little money in the country at this time, except what the British Government sent out for paying the troops and supplying them with rations). The farmers teamed the produce which they had to sell, down the country roads or along the bay or river to the lake shore to the stores, and went home laden in exchange with new goods—clothes, hardware, kitchen utensils, crockery, etc., to delight the hearts of their families.

We may consider one of these early stores as typical. It was situated on the Prince Edward County shore of the Bay of Quinte about six miles west of Bath, and we are so fortunate as to have its bill of sales for 1797. The retail sales for the year amounted to about $4000. Of this amount about $1,400 represented dry goods, $200 groceries, $440 spirits, $240 tobacco, $58 crockery, $170 hardware and nails, $431 clothing, $180 hats, $110 boots and shoes, $44 pots and pans, and $20 books and stationery. From this list we can see that our ancestors were a severely practical people, with little desire for wasting time in book-learning. The books which the store did sell were either of a utilitarian nature such as account books, spelling books and almanacs, or religious books. A Bible was sold for about $1.50, a Testament for 60 cents. It helps one to realize the dearness of foreign products—due, of course, to the great difficulties of transportation—when one is told that the cheapest tea in this store was 80c. a pound, and green tea ran up to nearly $1.50. Such stores as this were a great benefit, as they took the farmer's products from him and disposed of them at a considerable distance—something which he could not well do for himself, though he would have had to do it, if the stores had not brought things in for him. This is another instance of the division of labor.

The war of 1812 naturally provided the farmer with a larger market. The number of troops in the country was greatly increased, and obviously that meant higher prices for the farmer's products. In the year 1812 the average price of grain in Montreal was about $2.60 per bushel, and in 1813 and 1815 it was about $2.18. This price naturally declined when peace was proclaimed and the farmers who were out on service allowed to go back to their work and the extra troops taken away. In 1820 wheat was only about 60c. per bushel, but after a preferential treatment was accorded by Great Britain, prices greatly improved, and the average price in the three years, 1836, 1837, 1841, was $1.18 per bushel in the market at Montreal. Farmers accordingly grew wheat in considerable quantities for export. In 1841, a banner year for Canadian trade up to that time, (Canada, of course, including only Quebec and Ontario) we have among the exports: $600,000 worth of pot and pearl ashes, $3,300,000 worth of wheat, and roughly $5,000,000 worth of timber. By this time, then, our country was beginning to send abroad products of considerable value, receiving in exchange for them fine manufactured articles of various kinds, such as it could not at that time produce for itself.

Roads

Settlement at first proceeded along the lake front and the rivers; on a great bay such as the Bay of Quinte, which was naturally considered more suitable for getting about than the open lake, settlement was especially common. Farms were also taken up around Niagara, the old fort of war times, and near Fort Detroit, and it early became a problem how these so widely separated places were to be kept together. The first governor, Sir John Graves Simcoe, deemed it necessary to do this by military roads, such as Yonge Street, Dundas Street and the Niagara Road. These may be seen on an early map of Ontario made in 1798 and reproduced in the report of the Canadian Archives for 1891. The Toronto and Kingston Road was constructed soon afterwards, and still later roads were run back from the lakes, notable among them being the well-known Hurontario St. from Port Credit to Collingwood. Settlement gradually spread northward from Lake Ontario and Lake Erie along the chief roads of the various districts, which did the work of our modern colonization roads. After a settlement was once established, every autumn the farmers of these new districts teamed their surplus products to the nearest lake shore port, from which these were shipped to the sea, for most of our exports at this time were sent to England. Conversely, most of the articles which we needed were brought to us from England.

Our population was for a long time almost purely agricultural in spite of its rapid growth. The early settlers who came from the United States or Great Britain were almost all agriculturists, and even those who were not found themselves virtually compelled to resort to agriculture once they arrived in Canada. The lot of the poorer classes in England was hard at this time, and hence a great many came to Canada. As a result we have a rapidly increasing population. The nucleus of the ten thousand United Empire Loyalists in Upper Canada in 1784, grew to 70,000 in 1806, 95,000 in 1814, 1[illegible]0,000 in 1824, 213,000 in 1830, 455,000 in 1841, 952,000 in 1851, 1,396,000 in 1861. The 600,000 acres of land cultivated in 1826 increased to 3,705,000 acres in 1851, and to 6,050,000 acres in 1861.

In 1830 there were only five towns in the province with over 1,000 population, viz.: Brockville, 1,130; Hamilton (including township) 2,013; London (including township) 2,415; Toronto, 2,860; Kingston, 3,587. These were too small to provide any "home market" of consumers who could use up the farmers' surplus products. In 1850 (according to Smith's "Canada, Past, Present and Future") the population of Brockville was 3,000; Hamilton, 10,248; London, 5,124; Toronto, 25,166; Kingston, 10,097; Brantford, 3,200. Toronto had then 2½% of the total population of Ontario; she has 15% of it to-day.

This first part of our sketch of the history of Canadian economic development may be said to close with 1850. In the sixty-five years that had elapsed since the settlement of the Province, we have seen the individual farmer at first as a sort of Robinson Crusoe thrown upon the Northern coast of the Great Lakes with the few tools and necessaries of life saved from the wreck of his fortunes. He was in the position of having to do everything for himself, both because he was so remote from anyone else and too poor to pay others to do his work for him. Then as he cleared more land and began to produce more than he needed, the sale of the surplus to the troops or for export gave him some opportunity of acquiring wealth and hiring people to do for him what he could do for himself only in a clumsy and inefficient way; so we have the millers, the tailors, the cobblers, the blacksmiths and wagon-makers, masons and carpenters, pedlars and store-keepers beginning to do for the farmer what he had been in the habit of doing for himself. It paid him to let them do it and to devote himself to his farm, securing the largest and best product possible from his land. Later we find the surplus product of the farmer becoming sufficient to support, though in a poor sort of way, professional men, teachers, preachers, doctors and lawyers. This condition is somewhat similar to that existing in the French Canadian seigneurie, where the tithes collected from the habitants supported the curé.

The old life had its charms—particularly the charm of being independent, doing everything for yourself. The early farmer was not dependent on the good-will of anyone. He had no such fear as, for instance, the modern fruit farmer has, of a strike on the railway preventing his fruit from getting to market. But we must remember that this independence meant hardship, that a single man is weak against nature, that it is impossible for one individual to do all things well, and that when each man has his special line of production in which he is an expert, production becomes most efficient. So in our day we have sacrificed the independence of the individual to economic efficiency—the greatest total amount of product. The great Adam Smith, in the very first chapter of the Wealth of Nations, pointed out the great advantages of the division of labour, taking the manufacture of pins as an example. He said that where one man working alone and performing all the processes himself could make perhaps 20 pins in a day, ten men dividing the processes could make 48,000 in a day—4,800 each—an enormous increase in efficiency. So too, our farmer found that he could not make flour from his wheat so efficiently as the miller, nor make shoes so efficiently as the shoemaker, nor build so well as the masons and carpenters. Therefore he let these people work for him, and paid them out of the greater product which he secured through being able to devote his whole time to his farm, and he gained by doing so. This division of labour is, as we shall see in the next lesson, still going on more and more down to the present time and greater and greater efficiency in production, shown by increased product, has been the result.

The student may supplement this account by reference to his own experience, and by inducing older people to tell him about the early settlers and the way in which they lived. Professor Wrong's "A Canadian Manor and its Seigneurs" will give him a good idea of life on a French Canadian seigneurie, and Haight's "Country Life in Canada Fifty Years Ago" or Strickland's "Twenty Seven Years in Canada West" will give him a fine picture of early life in Ontario. The student, to get full value out of the work, should apply the principles he learns to the economic development and present economic condition of his own locality.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON 3.

1. What are the chief differences between early methods of production and those in vogue to-day?

2. Describe the early French-Canadian seigneurie.

3. What dues did the seigneur receive from the habitants? What services did he render them in return?

4. Describe the habitant's method of making his living.

5. Describe the life of the early United Empire Loyalists, and their first efforts at agriculture. How did they make clothes and grind their grain?

6. Who were the first non-agricultural workers? How did they carry on their respective industries?

7. Give reasons for the rise of the little country hamlets, with their blacksmith shops, taverns and little stores. Why has the business of most of them declined?

8. Give an account of an early store. Where would such stores naturally be situated?

9. In such a store, what commodities would probably be dearer than to-day, what commodities cheaper, and why?

10. Why did prices rise in the war of 1812? Why do they usually rise in war-time?

11. Toronto had in 1851 about 2½% of the population of Ontario, in 1911 it had 15%. Why such a disproportionate increase?

12. Give instances from your own locality to show the increasing division of labour in industry. Show how it makes for efficiency.

ECONOMICS

LESSON 4

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ECONOMICS

LESSON IV.

Modern Agriculture and Transportation.

Agriculture.

IN the last lesson we dealt with the development of Canadian agriculture down to about the year 1850, and showed how with the gradual settlement of the country there was a continuous process of specialization of labour—how at first the pioneers produced almost everything for themselves, and went without what they could not produce, while at a later date they were able to hand over such work as tailoring, blacksmithing, shoe-making, store-keeping, etc., to people who, through exclusive attention to these respective branches of work, were able to produce more efficiently and cheaply. Production is most efficient where, as the old proverb has it, the cobbler sticks to his last and others also devote themselves exclusively to their respective trades.

In the present lesson it falls to our lot to study the later development of our Canadian agriculture—a development which proceeds in the main along the same line as that already noted—the line of specialization, or, as economists prefer to call it, the division of labour. There is, however, another important feature in the development of agriculture during the past half-century—the introduction of agricultural machinery. The agriculture of the present differs from that of the period with which we dealt in our last lesson in two main points, first, the greater specialization in the type of agriculture followed; second, the introduction of machinery. I find it advisable to deal first with the introduction of machinery.

Introduction of Machinery.

The farmer of half a century ago had comparatively few tools to help him in his farming. He had, of course, his wagon, his plough, spades, shovels, picks, harrow, etc., but the part of his work in which he could avail himself of the help of machinery was far smaller than it is to-day.

The great extension of the use of machinery may be seen from the statistics. In the 1861 census of Upper Canada—the first census when such information was collected—the farm lands are valued at $295,163,315; the farm implements used to cultivate them at $11,280,356—about one twenty-sixth of the value of the land. According to the census of 1901 the value of farm lands in Canada was $1,004,923,792 ; of farm implements, $107,630,565. The value of the implements is thus seen to be more than one-tenth the value of the lands. Indeed, in the Western provinces it reaches one-sixth of the value of the lands. The tendency, we may safely say, is for this ratio to increase, and for the value of the implements used in cultivating the land to bear a greater proportion to the value of the land itself. Mr. C. C. James points out that there has been a tendency for the prices of agricultural machinery to decrease, so that the real increase in the amount of agricultural implements in use is much greater than is indicated by the figures. Twelve million dollars worth of agricultural machinery was produced in Cananda in 1905.

What is the consequence of this great increase in the use of machinery? Simply that much of the work formerly done by the manual labour of human beings is now being performed by machinery, which has to a very large extent taken the place of human beings on the farm as in the workshop. By its aid fewer workers are now able to turn out a greater product with greater ease than in former times. The amount of drudgery in farm labour has very much declined as a result, and the average farm laborer of the present day, always excepting those whom we may call apprentices to farming, is a more intelligent and efficient person than he was 50 years ago, as it is necessary for him to have a considerable knowledge of machinery.

"The great improvement which has taken place in agricultural methods and machinery enables the relatively smaller farm population to satisfy the demand for agricultural produce even more completely than in the past. That is to say, the machine power introduced into farming has more than taken the place of those persons and their descendants who have abandoned agriculture. It has been estimated that in 1895 in the United States it actually required only about 120,000,000 days' work to produce the nine principal farm crops of that year, whereas had they been produced by the methods and machinery of 1850, at least 570,000,000 days' work would have been required''.

(H. W. Quaintance, ''Influence of Farm Machinery on Production and Labour,'' pp. 27-29).

If we accept Mr. Quaintance's conclusions, we see that nearly four-fifths of the labour put upon the land in 1850 was in 1895 done by machinery. It is entirely probable, though the paucity of our statistics makes it an assertion impossible to prove, that the same holds good for Canada in 1910—that a given quantity of agricultural commodities can be produced with one-fifth of the manual labour required in 1850. Is it not natural, then, that the surplus labour once employed on the farms resorts now to the towns, as the farms, at least under the ordinary system of extensive farming, can no longer provide that labour with employment?

Decline in Rural Population.

One of the results of this is a relative decline in the population of old-established farming communities, which now require less labour than they did a generation ago. The Ontario Bureau of Industry reports that in the comparatively short period from 1900-1909 the rural population has declined from 1,108,874 to 1,047,000, a decrease of 5.5%, while in the same years the urban population increased 32.75%. The Dominion census of 1911 tells the same story. The aggregate population of towns of 4,000 or more inhabitants in the Dominion of Canada has increased from 1,200,000 to 2,400,000, or roughly 100%; the population of rural districts and villages and towns under 4,000 has increased from 4,200,000 to 4,800,000 or 14.2%. This is the case in a country where the call of the land is more insistent and the opportunities on the land are perhaps greater than anywhere else in the world.

The very considerable shifting of our agricultural population to the cities or to the new lands of the West, has been going on for some forty years. Rural Ontario, in its more southern parts at least, was probably most thickly settled about 1871, and the present rural population of the Province, even taking into account the colonization of New Ontario, is only about equal to what it was in 1867, when the Dominion first came into existence. The same situation exists in the Maritime Provinces and nearly the same in Quebec, where in spite of the agitation for the colonization of the Lake St. John country, rural population is practically at a stand-still. It is only in the three Prairie provinces of the Dominion that the agricultural population can be said to be on the increase.

Some examples taken from old-settled rural communities will emphasize this displacement of the rural population. They can be duplicated almost anywhere in the older settled rural communities of Eastern Canada, wherever fruit culture and market gardening have not taken the place of the former extensive farming.

The township of Chinguacousy, in the county of Peel, is a fertile agricultural district, with a soil well adapted for the raising of root and grain crops. Its population at the various censuses since 1861 is as follows:—1861, 6,897; 1871, 6,129; 1881, 5,476; 1891, 4,744; 1901, 4,177; 1911 (assessor's figures), 3,381. There are only 49 people now resident in the township for every 100 resident there in 1861—a decline of over one-half.

The county of Prince Edward is an old-settled agricultural community. Its population, exclusive of the town of Picton, is as follows:—1861, 18,802; 1871, 17,975; 1881, 18,069; 1891, 15,602; 1901, 14,166; 1909, (assessor's figures), 12,382. This shows a decline of 34%, and is unduly favourable to the rural population, since the two growing villages of Wellington and Bloomfield have had to be included throughout.

The county of Iberville is an old-settled agricultural community in the Province of Quebec. Its population, exclusive of the town of Iberville was in 1861, 15,301; in 1871, 13,916; 1881, 12,612; 1891, 10,183; 1901, 8,161. Here we have a decline of 46 per cent. in forty years.

The population of King's county, Prince Edward Island, which, with the exception of the village of Georgetown, is an almost purely agricultural community, declined from 26,433 in 1881 to 19,826 in 1901, a decline of over 25 per cent.

This decline in rural population is regarded by a great many keen observers as a national calamity, a symptom of decaying vitality. There is some truth in the allegation, but it appears to the writer to be very greatly exaggerated. City life in these days is not usually unsanitary or enervating, as it was a couple of generations ago, when contagious diseases rapidly spread unchecked among crowded populations and weakened those whom they did not kill. Nor again is farm life so particularly healthy as is sometimes imagined. Bad water, bad cooking, distance from medical attention, and other conditions so often present in farm-life tend to make life on the farm no healthier than city life. The great economic reason for the exodus from the farms is simply that there is not sufficient fairly-paid work there to give the laborer a decent living. Our winter seems inevitably to stop all farm activities for several months, and the laborer who cannot find work during these months, naturally drifts to the city. If the city provides him sufficient fairly well paid work, he stays there. Since so many indoor industries which used to be engaged in on the farms during the winters have migrated to the cities, it is only natural that they should carry along with them the labour which they formerly employed on the farm.

Specialization in Farming.

While early specialization in Canadian agriculture was concerned mainly with taking over from the farmer duties which have no necessary relation to farming at all, the later specialization is mainly in the different branches of agriculture itself. It is now recognized that farming is not a single industry, but a great body of industries. No man can be an expert in all kinds of farming at the same time. The life of the fruit farmer of the Niagara Peninsula or the Annapolis Valley or the dairy farmer of Ontario or Nova Scotia, is very different indeed from that of the wheat farmer of the prâiries. If any one of them were transplanted into the place of any other, he would find himself with a very great deal to learn, and would make many mistakes in the learning of it. On the whole, the productive power of the country would be lessened by the interchange of work. As things are, we find the fruit farmer of the Niagara Peninsula obtaining his wheat from Manitoba and his milk from the dairy farmers of the higher grounds near his farm. The prairie farmer gets his fruit from Ontario. The dairy farmer very probably does not produce enough wheat to feed his own family. All these are interdependent on each other. It is usually a mistake to say that the modern farmer is economically independent of the rest of the world. The fact is that if he is a progressive farmer he will confine himself to his specialties, and will depend upon other farmers to supply him with many of his food products. There is one qualification to be made to this statement. If the farmer's specialties occupy him only at certain seasons of the year, he may very well devote himself to work which can be done at a time when it will not interfere with his main vocation, even though he is not an expert at this second kind of work.

This increasing division of labour among farmers issues from two main causes. (1). The farmer learns to grow those crops which his land is best adapted to produce. (2). He learns to grow those crops in the production of which he is most proficient. It is on record that the early farmers neglected the fruit lands on the south shore of Lake Ontario as worthless, becanse they were not adapted to the production of wheat. It was not until long afterwards that this land was found to be admirably adapted to the production of fruit. In order to secure efficient production, then, it is necessary to have the right man on the right land.

The chief essential to a properly specialized system of farming is the formation of associations interested in various specialties and the widespread dissemination of information on all sorts of subjects interesting agriculturists of various kinds. Such are the ''Dominion Fruit-growers Association'' and the association of the breeders of Jersey cattle. The function of encouraging such organizations and promoting agricultural education is performed fairly well by the Federal and most of the Provincial Governments as is evidenced by the Dominion Experimental farms and the Ontario Agricultural College. Also it is of importance to have in each section what we might call an agricultural chemist who after analyzing their soils will tell the farmers what crops to grow.

The Ontario Government has lately adopted the plan of putting an agricultural expert into each county. He should be able to advise on varieties of seeds, etc. All money wisely spent in furthering agricultural development is sure to be exceedingly reproductive. The state can spend money in no better way. (The student should, if possible, procure the 31st. annual report of the Ontario Agricultural and Experimental Union, 1909, and read Mr. C. C. James' account of his visit to Svalof, Sweden, where a new variety of wheat has been produced, which in 1908 yielded on one plot 70.4 bushels to the acre, and on the average of all experiments in that year yielded 56.2 bushels to the acre.)

The effect of an enlightened policy with regard to agriculture can be clearly shown by our Canadian statistics. In 1901 there were 472,000 farmers producing to the extent of $365,000,000—an average production of $769 worth of commodities. There were estimated to be in 1909 575,000 farmers in Canada with a total population dependent upon agriculture of 3,775,000, an investment in this basic industry of $2,440,000,000, and a yearly agricultural revenue of $700,000,000, or $1,217 per farm. The great increase is, of course, partly due to the higher price of the farmer's products in 1909, but it is attributable mainly to the better type of farming and better agricultural education, more careful discrimination between different varieties of seeds, etc. In spite of occasional bad seasons, the farmer is, on the average, better off every year, and the prospects of Canadian agriculture and Canadian agriculturists are of the brightest.

Transportation.

In order that the specialization which we have described may exist among the agricultural community, it is essential that the specialist in one kind of production shall be able to send his surplus products away to some other specialized producer who sends in return a portion of his surplus product. The wheat farmer from Brandon sends, directly or indirectly, his surplus commodities to the Niagara fruit farmer and receives the latter's surplus fruit in exchange. Both of them profit by the transaction. The Manitoba wheat farmer gets his fruit cheaper and the Ontario man his wheat cheaper than he could have produced it himself. There is a real gain to both sides.

What makes the gain possible? Clearly the possibility of sending fruit from Ontario to Manitoba, and grain from Manitoba to Ontario at a reasonably moderate cost of transportation. If that cost were too high, or if the transportation agencies suddenly ceased to act, the goods would cease to be sent, and the Westerner would be forced to produce his fruit himself, and the Easterner his wheat. If a strike of all our transportation employees occurred, our cities would be in a state of starvation within a few weeks—perhaps in a few days. If a man ceases to produce the necessaries of life for himself, he becomes dependent on other men to produce those necessaries for him. And if others produce those necessaries for him in return for the commodities which he produces, then it is necessary that those commodities of theirs shall be brought to him and his surplus commodities taken to them. This costs money, and it may well be that in some cases it will be found that although A does not produce a certain commodity so efficiently as B, yet it will be better for A to produce it for himself than to pay B for it at B's place of business and then pay for the labour of bringing it home. Whenever transportation takes place, an actual service has been performed—to put it in economic language, a place-utility is created.

All agriculture—and indeed all other business—is profoundly affected by the increasing cheapness and rapidity of transportation, which has made it possible for farmers to specialize—for the farmers of the Niagara peninsula to exchange their surplus fruit for the surplus wheat and flour of the North-West. Of course, the fruit costs the Manitoba farmers more than it would have cost consumers in Hamilton, but it costs them less than it would have cost them to produce it themselves. (This is an extreme example, as many fruits cannot be raised in Manitoba without greenhouses and steam-heat, but it illustrates the general principle.)

Cheap transportation and easy communication are primary necessities in the life of a modern society. Every business man that you talk to, every newspaper that you pick up, has something to say about passenger rates, freight rates, good roads, canals, lake and river transportation, the carriage of letters and express parcels, telephones and telegraphs, etc. A strike on the railroads or in the telephone service causes the greatest inconvenience to thousands, perhaps to hundreds of thousands. To take only one or two instances: the milk supply of Toronto or Montreal or any other large city could easily be shut off by a strike affecting the railway lines. The coal supply, which is rarely sufficient for more than a few weeks at the most, would be similarly affected. The suffering inflicted upon those who dwell in cities would be incalculable. Transportation is, then, a very important factor in the economic life of a country. It cannot be left entirely to employers and employees to say just when that transportation should be stopped. The public is deeply concerned with rates and prospective stoppages of transportation, so we have the Government appointing a permanent Railway Commission to fix rates, and passing an Industrial Disputes Act to compel an investigation of the causes of quarrels between masters and men which threaten to tie up the business of the country. This public investigation usually leads to a peaceful settlement of the quarrel.

Water Transportation.

Water transportation is much cheaper than land carriage. Before the era of railroads, the difference was even greater than it is to-day. The early settlers of Canada naturally settled where water transportation was available, as the thick bush made land transportation very difficult. During the whole earlier history of the country—before the age of railroads—water transportation was everywhere in use. During the whole of the French and the early part of the English occupation of Canada, the St. Lawrence was the chief means of communication. After the commencement of settlement west of the Lachine Rapids, it became necessary to portage goods where the water was unnavigable. This cost a lot of money ; therefore we have canals built in order to avoid the necessity for it. Short canals at the rapids of the St. Lawrence were constructed 1779-1781, and were enlarged in 1804 and 1817. The Lachine canal was constructed 1821-

1825, and the Welland 1824-1829. The Rideau canal was constructed by the Imperial Government about 1834, and was a way by which immigrants came up to Canada West, until the enlargement of the St. Lawrence canals in 1847 permitted direct passage up the river to Kingston. Our canals and river service have been eclipsed as a passenger service by our railways, but for slow and heavy freight, water transportation is still everywhere preferred on account of its superior cheapness. The initial cost of these canals has been about $97,000,000.

To-day we have in existence a great freight route from Port Arthur and Fort William to Lake Erie, by way of the Sault Ste. Marie canal. We have schemes for enlarging our canals on the St. Lawrence system, and for a new Welland which will allow large ocean freight steamers to come right up the river and through the Great Lakes up to the head of navigation at Port Arthur and Duluth on Lake Superior. *This would, of course, cost immense sums of money, but it would be well worth all it costs us to be able to send our grain, etc., from Port Arthur to Liverpool without transhipment. The expense of transhipment is very considerable, and various delays are involved. No doubt there will finally be adopted some comprehensive scheme of canal construction, but just at present Canada has many ways in which to expend her borrowed money.

Roads.

The roads of Canada before the time of the railroads ran back from or alongside water routes, or often formed portages between two spaces of water communication. Thus in Upper Canada main roads run for the most part north and south, except the great east and west road which runs along the St. Lawrence and Lake Ontario west to Goderich. With the exception of a few of these principal roads, the highways throughout the Province of Ontario, as well as

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*Vessels of 15,000 tons belonging to the United States Steel Corporation now bring down ore from Northern Michigan and Wisconsin to Erie and Buffalo. The chief hindrances to navigation are between Buffalo and Montreal, and the deepening of the Welland Canal and the St. Lawrence canals would remove these hindrances.

most of those elsewhere in Canada, have been shamefully neglected. The primitive method of paying one's road tax by working on the roads (statute labor) is still widely prevalent, and as long as that is the case, little real improvement of roads repaired in that way can be effected. It seems a curious commentary on the lack of enterprise displayed by so many farmers, and the low value which they put upon their time that we find them performing statute labor, when the cost of commutation is only $1.00 per day. Of late years the good roads movement has arisen, and expert road makers are being employed in a number of counties to macadamize the principal roads. The Province of Ontario has thus expended $1,000,000, and the counties $2,000,000 within the past ten years. Nothing could be a greater boon to the agriculturist than this improvement of roads, which decreases his cost of transportation, making the cost of bringing wheat to market, let us say five cents per bushel instead of ten cents. The same saving of effort takes place in everything transported to or from the farm, and the result is a considerable addition to the farmer's income and to the cash value of his farm.

Railways.

The greatest transportation agencies in Canada to-day are the steam railways, which form the bands that link our widely scattered provinces together. Without the railway the Dominion could scarcely have been extended west of Lake Superior, and the agreement with British Columbia which carried our boundaries to the Pacific Ocean, had as its chief condition the construction of the Canadian Pacific Railway. The continuance of a vigorous policy of railway construction appears to be the only way in which we shall be able to secure the settlement of our vast territories

The whistle of the locomotive engine was first heard in Canada in the year 1836, when our first railway, almost a toy, was constructed from Laprairie to St. Johns, Quebec, a distance of 16 miles. For a time progress was slow. In 1850 there were still only 66 miles of line in Canada, but the next decade saw a considerable development. In 1853 the Northern Railway was opened from Toronto to Bradford;

in 1856 communication was established between Toronto and Montreal, and in 1858 between Toronto and Sarnia by means of the Grand Trunk Railway. Thus in 1860 there were 2,065 miles of railway in the country. In 1870 there were 2,617 miles: in 1880, 7,194 miles; in 1890, 13,151 miles; in 1900, 17,657 miles; in 1910, 24,731 miles of line—the largest amount of line in any country of our population in the world. The great increase in the service rendered by the railways is shown by the fact that whereas 5,190,416 passengers and 5,670,836 tons of freight were carried in 1875, in 1910, 35,894,575 passengers and 74,482,866 tons of freight were carried by them. Canadian railways (excluding those owned by the Government) had at the end of 1910 a total capital of $1,410,297,687, gross earnings of $173,956,217, working expenses of $120,405,440. Their net earnings were thus $53,550,877.

The railroad, like other transportation agencies, earns its money practically as a toll. Just as the miller mentioned in our last lesson levied a toll upon the wheat which he ground—1/10 or 1/12 as the case might be—so the railroad's freight earnings are simply a toll on the commodities conveyed by it from the producer to the consumer. Conceivably it might take these tolls, as the miller did, in kind—in wheat or other grain, etc. But that would involve much trouble in many ways, so the railroad prefers to get its receipts in actual money. With this money it pays its workmen, keeps its lines in repair, maintains its rolling stock, and the $53,000,000 net profits represents the excess of receipts over disbursements. This money goes to those who have invested their capital in the building and equipping of railways, which they would not have done if they had not expected some gain from the investment. Assuming that the $1,410,297,687 of stock represents capital actually invested, the dividend to the shareholders is not very great, averaging less than 4% on their investment.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON 4.

1. Show by statistics the increase of the use of agricultural machinery in Canada. Is the use of machinery increasing in your neighborhood? Are the farmers who use the most machinery making the most money?

2. What has been the general influence of the introduction of machinery upon the character of the agricultural population?

3. Is the rural population increasing or diminishing in your neighborhood? Give a full explanation. (Volumes of the Dominion census are to be found in almost every public library.)

4. Is the decline of rural population a calamity? Give reasons for your answer.

5. Give instances from your experience of specialization in farming. Does the specializing farmer make more money or live better than the farmer who does not specialize?

6. Quote statistics showing the increase of agricultural production in Canada. What qualifications are to be made in accepting these statistics?

7. What would be the result in your district of a general strike of railway employees in the summer? in the winter?

8. How does the government show its interest in the business of transportation?

9. Draw a map of Eastern Canada, showing the chief canals, and tell how they are useful to the country. (See section on canals, Canada Year Book, obtainable through your M. P.)

10. What are the best roads in your vicinity? When were they constructed and how are they maintained?

11. Trace the growth of the railway system of Canada. How is it being extended at the present time?

N.B.—Students would do well to consult the good farmers and business men of their neighborhood in framing their answers to these questions. Also they should make use of such government publications as the Dominion Census and the reports of the Provincial Bureaus of Industry.

ECONOMICS

LESSON 5

By

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ECONOMICS

LESSON V.

The Manufacturer

THOSE who have carefully studied the preceding lessons cannot have failed to be impressed with the great difference between our methods of production and those of our ancestors. We have noted these advances in the case of agriculture—the change from the scythe to the reaper, from the hoe to the cultivator, from the hand-rake to the horse-rake—from less efficient to more efficient methods of production, involving the division of labour and increasing specialization. This change, we have seen, has, by its widespread and far-reaching consequences, deserved the name by which it is sometimes called—the "agricultural revolution."

Greater even than the agricultural is the industrial revolution—the supersession of the old domestic system by the factory system of industry in what we call manufactures. That word itself gives us a clue to the nature of the change. It comes from the Latin words, *manus,* a hand, and *facere,* to make. It means, therefore, "to make with one's hands," and any person who made articles by the labour of his hands was called a "manufacturer" in the original sense of the words, while his workshop might be called a "manufactory," a word which has been abbreviated into "factory."

Our modern manufacturer, however, does not work with his hands. He has machines to do it for him, and employees to tend the machines. He himself works with his head rather than with his hands. Again, when we speak of a "factory" we do not mean what men originally meant—a little shop, whose owner works there with his hands. We think of a great shop, with belts and machinery, or possibly electric motors, whizzing continually, and with a considerable number of people busily engaged in these shops for so many hours every day.

What is a Factory?

There has been some dispute about which is the more fundamental idea in the word "factory," as we apply it to-day. Would the concourse of wage-earners working each man with his own hand-power, constitute a factory if there were no machinery at all, no engines, no belts, no motive power? For example, is a place where men co-operate in painting buggies by hand a factory? The best authorities say it is; but whether such a place may be included or not, the typical factory suggested to our minds by the word is one where some motive force—water, steam, or electricity—is continuously used in manufacture. In most cases, indeed, it is the location of this motive power in some certain place which has made it expedient for wage-earners to come together there from all points of the compass to secure work that they could not secure at home. Mr. Carroll D. Wright, in his well-known Report on the Factory System of the United States, gives the following definition:

"A factory is an establishment where several workmen are collected for the purpose of obtaining greater and cheaper conveniences for labor than they could procure individually at their homes; for producing results by their combined efforts which they could not accomplish separately; and for preventing the loss occasioned by carrying articles from place to place during the several processes necessary to complete their manufacture. The principle of a factory is that each laborer, working separately, is controlled by some associating principle which directs his producing powers to effect a common result which it is the object of all collectively to attain. Factories are therefore the legitimate outgrowth of the universal tendency to association which is inherent in our nature, and by the development of which all industrial success has been gained; and from this principle springs the necessity for subdivision of labor, without which the factory system would have met with but feeble growth. The more the principle of association appears prominent in any species of production, the more rigidly does it become entitled to the name of factory, and the more generally does it receive the name in common parlance."

In manufacture, just as in agriculture, great increase in production arises from the division of labour, independent of anything else. That division of labour is best attained where men who perform different operations upon the same article are working in the same workshop; also, there is less loss of time than if each man performed this operation in his own cottage, as he might conceivably have done.

These are, nevertheless, minor advantages as compared with that of having the powers of nature—water-power, steam-power, or electric-power—harnessed at a certain place to do your bidding. It was indeed Watts' invention of the steam-engine which gave the death-blow to the old system of producing manufactured goods, of weaving, spinning, etc., in the worker's own house—the domestic system as it was called—and inaugurated the industrial or factory system as we understand that word to-day.

To us to-day the mechanical marvels which spring from man's control over the powers of nature are an old story, and we find it difficult to work up any great enthusiasm over labour-saving machinery. We cannot realize how wonderful the steam railway seemed to the contemporaries of George Stephenson, or the power loom to the men who witnessed its introduction. Yet the effect of such inventions in the different societies where they have been successfully introduced is simply incalculable. Britain, where they first came into use, owes her triumph over her great enemy in the Napoleonic war even more to her machine industry than to the victories of Nelson and Wellington. The great prosperity proceeding from her unprecedented rate of production enabled her to finance the most expensive war in the history of the world.

The Industrial Revolution

The industrial revolution began in England in the latter half of the eighteenth century with inventions which completely changed the character of the woollen and cotton trades. Spinning was the general employment of unmarried girls who, even to-day, are in law described as spinsters. These girls were unable to spin enough yarn for the weavers, and when John Hargreaves invented the spinning-jenny, by which one spinner could spin many threads at a time, it gave a great stimulus to weaving by providing an almost unlimited supply of raw material. Richard Arkwright also invented a water-power frame for spinning, and Edmund Cartwright, a clergyman, invented the power-loom. The utility of these various machines was enormously increased by James Watts' steam-engine, which was soon applied to the work of running them. (Cartwright at first used a bull to operate his power-loom, but after a time he set up a steam-engine.) Gradually—more gradually than would be the case now—the new machines came into general use, and greatly decreased the cost of producing cotton and woollen cloth. The competition of the machines proved most disastrous to the handworkers, who were driven to starvation and pauperism.

Industrial Supremacy of England

In spite of all this, the introduction of the new machinery marked an enormous advance in national prosperity. It gave the British people a tremendous advantage over those of other countries. The English machine-worker could make far more of a given product in a given time than a Continental hand-worker, and although he got higher wages, his wages were less per unit of product, so that he was cheaper to his employer. Thus the English manufacturer could sell his goods on the Continent for less than the price at which the Continental producer could compete. This English monopoly of machine production went on for a generation at least, and as a consequence of it all, we have the Continental nations crying out for protection against the cheap wares of England; and yet those wares were produced by workmen who were much better off than their own.

Here is a German tribute, written in 1805, to the commercial supremacy of England: "A nation that by her activity and the genius of her citizens, manufactures its numberless articles of merchandise, infinitely finer, in much superior workmanship, in far more exquisite goodness, than all other nations, without exception; and that is able to sell them infinitely cheaper, owing to her admirable engines, her machines, and her native coal; a nation, whose credit and whose capital is so immense as that of England; surely such a nation must render all foreigners tributary; and her very enemies must help to bear the immense burthen of her debt and the enormous accumulation of her taxes."

The unsettled state of the Continent of Europe during the Napoleonic wars made it inadvisable for the capitalists of that period to invest their money in buildings and factories which might at any moment be destroyed by contending armies. Indeed, the forced contributions levied by Napoleon upon his own and other nations absorbed the greater part of the savings of that period. England thus achieved a commercial and manufacturing supremacy which was for some time unchallenged. By the end of the wars, her manufacturers had acquired a connection and a supremacy which made it very difficult for the manufacturers who, after 1815, began to build factories in other countries, to compete with the English. But, as happens in the political life of nations, predominance provokes jealousy and attack. The other leading nations of the world felt themselves too much at the mercy of England, and therefore they began to encourage native manufactures by bounties and import duties, just as we in Canada are encouraging our manufactures by these methods to-day. This policy has been pursued most deliberately by Germany, at first through the Zollverein or Customs Union of the separated German States, and later through the Imperial Government, and by the United States.

In both these countries, as well as in most others, we find the governments placing a more or less heavy duty on the importation of foreign manufactured goods. Their aim was to encourage native producers to set up in business for themselves, and to give them financial aid, either directly by bounties or indirectly by customs duties, until they had accumulated large capital and were able to compete on even terms with the long-established British manufacturers of these articles. In the meantime the people of the protecting country who were not engaged in these industries were paying higher prices than was really necessary in order to help the producer of these goods. This policy may have been worth while, but certainly the consumer has had to pay for it. It is possible, however, that when the protected industries finally become established and their protection is removed, they may be able to sell to their consumers cheaper than foreign producers could, since they will then be able to produce as cheaply as their foreign competitors, while their cost of transportation will be less. Thus the consuming class may in the end be compensated for the burdens placed upon it. This, we trust, will yet be the case in Canada.

Protection in Canada

Up to 1846, when by the repeal of the Corn Laws, the British Government removed the preference which she had given to Canadian grain, English manufacturers received a preference in the Canadian markets, and it was virtually impossible for Canadians, on account of the scarcity and dearness of skilled labour, to compete with them in producing manufactured goods. The grant of responsible government to Canada, however, and the withdrawal of the preferential treatment formerly extended to this country logically involved the further principle that Canadians should control their own market and be free to make their own tariff, and in 1847 Canada adopted a budget which abolished all preferences to British products as compared with foreign. This tariff was for revenue only, but on the initiative of Canadians who felt that if a fair start could once be obtained their country's manufactures would soon become firmly established, a protective tariff was enacted in 1858. Against this the English manufacturers protested to the Secretary for the Colonies who, after some consideration, declined to interfere, on the ground that Canada was a self-governing colony. Thus a very important principle was recognized, which was still more firmly established by Section 91 of the British North America Act. This gave the Dominion Parliament exclusive legislative authority in all matters relating to "the regulation of trade and commerce," "the raising of money by any mode or system of taxation," and "navigation and shipping."

From 1858 to the present time, the principle of protection to the native manufacturer has to a greater or less extent obtained in all Canadian tariffs by whomsoever enacted. Before Confederation the tariffs of the Maritime Provinces were levied mainly with an eye to revenue (in Nova Scotia the average rate was 10 per cent., in Prince Edward Island 11 per cent., in New Brunswick 12 1-2 per cent.). Confederation involved free trade among the four provinces of the then Dominion, and we have what Prof. McLean, in his "Tariff History of Canada," calls a 15 per cent. tariff from 1867 to 1874, followed by a 17 1-2 per cent. tariff from 1874 to 1878. This rate was raised to a 20 per cent. tariff (the National Policy tariff) from 1878 to 1890. From that latter date there was a tendency to tariff reduction evident in the last years of the Conservative Government, due to the increasing restiveness of the people in a period of hard times under a tariff which had a tendency to increase prices at a period when it was difficult for the average citizen to make ends meet. This restiveness was partially allayed by the British preferential tariff, enacted by the Laurier Government in 1897; it has of late been once more increasing, especially in the West.

With regard to the expediency of this protective policy, from the point of view of the country at large, the greatest differences of opinion exist, even among those who may be considered authorities on the subject. There can, however, be but little doubt that in Canada, as in other countries, protection has been a great factor in upbuilding many important industries. We shall now trace the history of Canadian manufactures in general and certain representative industries in detail.

The Rise of Canadian Manufactures

When one looks back once more to the Canada of 1850, one finds it very different indeed from the Canada of to-day. Its towns were few and of second-rate importance, composed largely of government servants and commercial people—people concerned in the marketing of the primary products of the farm, the forest and the fisheries. There were few, very few, of the tall chimneys which are everywhere to be seen in the modern city. In fact, the Eastern towns, where the chief manufactures of the country are now carried on, were in this particular at least like the young Western towns of to-day, where manufactures have as yet had no time to become established—where the demand for the finer kinds of manufactured goods is supplied by bringing in goods from the East rather than by production on the spot. Into these small towns all fine manufactured goods were imported, principally from England, whose goods naturally enjoyed a preference in the colonies in return for the preference which she extended to their raw materials and food products—for example, to Canadian wheat and timber. The manufactures of the United States, still in their infancy, and handicapped by this preference given to British goods, found but little sale in Canada.

England, then, supplied us in the main with our finer manufactures down to about the year 1850, which we may, with Mr. Stapleton Caldecott, consider as the turning-point in our industrial history. There were some things with which England was not in a position to supply us, because she did not make them herself. In England, for instance, labour was so much cheaper than in Canada that the problem of securing men to cultivate their farms did not worry Englishmen as it did Canadians. Accordingly, we do not find in England the demand for agricultural implements that exists with us in a country where labour is harder to procure. England did not feel the need of machinery in her small area with many hands; therefore, she did not trouble herself greatly about agricultural implements, and did not produce them. But Canadians, in a large country with few hands, wanted to get as much labour done as possible, and found it necessary to produce for themselves. Thus, finally, a great implement industry was created, and our country to-day exports much more than she imports of these valuable machines.

We have already dealt with agricultural implements in so far as their influence on the farm was concerned. Now let us look at them a moment to consider the great industry which arose out of their manufacture.

The Agricultural Implement Industry

The agricultural implement industry in Canada is inseparably connected with the name of Hart A. Massey. His father, a prosperous farmer in Northumberland County, Ontario, imported in 1830 one of the first threshers ever seen in Canada, and afterwards imported other agricultural machinery. Feeling that there was a general need of such implements, he resolved to begin their manufacture. In 1847 he established a small foundry and repair-shop at Newcastle. In 1852 the firm, now H. A. Massey & Co., began to turn out the first mowers and reapers ever produced in Canada. As time went on, other farm implements were added to the list. In 1861 the manufacture of Wood's mower was begun, and in 1863 Wood's self-rake reaper made its appearance. The latter machine obtained the gold medal at the Paris Exposition of 1867. In 1878 the Massey harvester was produced. In the following year the works were moved to Toronto, where abundant labour was available, and better shipping facilities existed.

While this was going on, many other small foundries arose to supply the local demand in various towns throughout the country. These had an extraordinary run of prosperity for some time, and often received bonuses from the municipalities in which they were located. Begun, however, for the most part by men who were good mechanics rather than competent business men, these concerns were unable to meet the pressure of the hard times which followed in the seventies and nineties, especially as their capital was very small. Their sales were largely on credit, and when the price of wheat fell, the farmers whose notes they held were in many cases unable to meet their obligations, and thus these industries were themselves pushed to the wall. Hard times, again, meant a contracting market for their product, and in that contracting market the large firm with considerable capital, with business connection and great ability in the management, by an economic law as inevitable as the tides, necessarily drove its competitors out of existence. Some Ontario municipalities are still mourning the money which they sank in an attempt to bolster up their local implement industries.

In competition of this kind, events usually take the following course: The weaker firms go to the wall, and those of approximately equal strength who find themselves unable to supplant each other, agree to combine their forces in order to put a stop to ruinous competition and to secure the greatest possible benefit for themselves. This is just what inevitably happened to the Masseys in their relations with other strong and progressive firms. In 1891 the Massey Manufacturing Co., Messrs. A. Harris, Son & Co., Ltd., of Brantford, and Massey & Co., Ltd., of Winnipeg, were amalgamated into one company, with a capital of $5,000,000, under the name of the Massey-Harris Co., Ltd. At the present time the great American organization, the International Harvester Co., is trying to secure a share of the Canadian market by establishing a branch at Hamilton.

The Iron and Steel Industry

One industry frequently gives rise to another. Agricultural implements require iron and steel in their composition, and consequently we have the encouragement of an iron and steel industry in Canada. Also, the demand for iron and steel in the construction of railways, in ship-building, in the erection of large buildings, has brought it about that this age is sometimes called the "iron age" of the world's history. The "iron trade" is in Great Britain and the United States regarded as the barometer of industrial prosperity. The iron and steel trade is known as the "basic industry."

It was, then, natural that our people in Canada should want to produce their own iron and steel, in order to make their agricultural implements, to build their railways, and to construct their great office buildings. This was made possible by the existence of immense and valuable deposits of magnificent ore, especially in the St. Maurice district of Quebec, where a forge was set up by the French Government as early as 1737, as well as in Nova Scotia. For a long time, however, the great bulk of iron and steel used in this country was made in the United States by the great American steel mills of Pennsylvania. In 1887 an import duty of four dollars a ton was placed on pig-iron, with encouraging results; ten years later a bounty of at first two dollars a ton was paid for home-produced pig-iron. Under this bounty the quantity of pig-iron produced increased from 33,000 tons in 1897 to 740,000 tons in 1910, while the steel production in the latter year was 740,000 tons, as compared with 8,700 tons in 1897.* About $100,000,000 has been invested in the industry. While there has been great expansion in the past fifteen years, the increase in the use of steel has proceeded still more rapidly, so that the home product supplies only about one-half the needs of the country.

The Textile Industry

As early as 1842 the then Province of Canada was importing annually nearly $2,000,000 worth of cotton goods and $1,500,000 worth of woollen goods from Great Britain.

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*Details as to these bounties and the annual production of pig iron and steel are to be found on page 436 of the Canada Year Book for 1910. The total bounties paid from 1896 to 1910 amounted to $6,835,000 for pig iron and $6,356,000 for steel.

The woollens no doubt were the finer kind of goods, the Sunday suits which supplemented the homespun worn every day by the average inhabitant of the Province. Canada had at that time little prospect of establishing a cotton manufacture, since the source of supply of raw cotton—the Southern States—was far away, with no means of communication and with no established business connections. The case of wool, however, was different. Canada produced considerable wool; she made homespun of it. With machinery and a few skilled workmen and perhaps a little encouragement from the government, there was no reason at all why a flourishing woollen industry should not be built up, and the cost of transporting these goods from Great Britain saved.

Already, in 1842, machinery was in use to some extent; Upper Canada had 186 carding mills and 144 fulling mills; in 1844 Lower Canada had 169 carding mills and 153 fulling mills. In 1851 there were 385 carding and fulling mills in Canada and the Maritime Provinces.

The first power-loom in Canada of which we have record was introduced in 1837 at a small factory at Chambly, Quebec. In Ontario the factory system of woollen manufacturing was instituted by Barber Bros., of West Flamboro, who, after operating a paper and woollen mill at that village for some years, moved to Georgetown, where they purchased a small mill. Later on they moved to Streetsville, where they conducted a business on a larger scale, producing tweeds, shirtings, flannels and kidderminster carpets. In 1862 their mill had 2,000 spindles, employed 90 hands, with a monthly wage bill of $1,600, and produced 18,954 yards of cloth in August of that year.

Other mills soon sprang up. Frasher & Crashaws, established at Cobourg in 1849, had in 1862 45 looms, producing 800 yards of cloth a day. Andrew Paton in 1855 established a woollen mill in Galt, and in 1866 one in Sherbrooke. Mills began operations at Carleton Place in 1847 and at Almonte in 1857.

In 1871 there were in Canada 270 establishments for the manufacture of woollen goods, with annual wages of nearly $1,000,000 and a product of $5,500,000. In 1891 there were 377 woollen mills with 7,156 hands, wages of $1,884,000, and products of over $8,000,000. Owing largely to the fact that the later censuses do not include establishments with less than five hands, the statistics of the census of 1901 and the special manufacturers' census of 1906 are not comparable with the foregoing. An article on the woollen industry, published in Industrial Canada in 1905 estimates the number of wage-earners at 13,000 and the product (in 1901) at $11,425,000.

The cotton manufacture began at nearly the same time as the woollen. The first mill was established at Sherbrooke about 1844, and deserves notice as the first limited liability company in Canada. Others were established at Thorold in 1847, at Montreal in 1853, at St. John, New Brunswick, in 1861, and at Dundas in the same year. These five mills had increased to eight in 1871, with a product of $781,000; to 19 in 1881, with a product of $3,759,000; to 23 in 1891, with a product of $8,741,000; to 20 in 1901, with a product of $12,033.000; to 20 in 1906, with a product of $14,223,000. Of this amount, $7,924,000, or 55 per cent., was produced in Quebec. Thus, the cotton industry of Canada has increased twenty-fold since 1871. The relatively small increase in the number of mills, as compared with the enormour increase in the product, is an instance of an almost universal tendency to the concentration of business in a few large enterprises.

The Boot and Shoe Industry

The boot and shoe industry is also of considerable importance in the history of Canadian manufactures. The first factory of which we have knowledge was established in Montreal in 1828, and between 1840 and 1850 we have records of some half-a-dozen founded in Lower Canada. In 1847 Brown & Childs, the leading manufacturers of that time began the use of machinery by importing several Singer sewing-machines to put together the uppers of boots. As usually happens when new machinery is introduced, this action roused considerable dissatisfaction among employees who found themselves thrown out of work by this labour-saving invention, and the firm in question became so obnoxious to the populace that it was only by a considerable military force that the mob which burned the Parliament buildings in 1849 were prevented from burning the offending factory. In 1860 the McKay machine for the sewing of soles was imported by Scholes & Ames, also of Montreal. Since that time the use of machinery has become more and more common, and new machinery has from time to time been invented, which has increased the product with perhaps an actual diminution of labourers. This industry, like the cotton industry, employs very largely French-Canadians, and in 1906, 77 of the 138 establishments in Canada were situated in the Province of Quebec. These had a product of $13,705,000 out of a total for the Dominion of $20,264,000, or over two-thirds.

Summary of Canadian Manufactures

The foregoing are only a few of the leading industries, but their growth will serve to show the great development of manufactures in Canada during the past half-century, with the introduction of machinery and a favouring tariff.

That growth may be briefly summarized as follows:

Value of product,	1871	$221,617,000
	1881	309,676,000
	1891	469,847,000
	*1901	481,053,000
	*1906	718,352.000
(Estimated)	1911	1,200,000,000

This result is sufficiently wonderful when we consider what great manufacturing industries have arisen from such small beginnings in the past fifty years. The student will

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*The small increase between 1891 and 1901 is due to the fact that the enumerators in the former year included all industrial establishments, while in the latter they included only those employing five or more persons.

note the exceedingly rapid increase of the past ten years. Unfortunately, the results of the 1911 census are not at the present date available, but there is little doubt that the figure quoted above from the Canadian Manufacturer's estimate are quite justified.

Survivals of the Domestic System

While this enormous growth has taken place among the great industries of the country, it must not be concluded that the old domestic system of manufacture is dead. It survives in many forms and in many places. The small cobblers of our towns, the blacksmith shops of the country, the repair shops for machinery, are all remnants which have survived from the past, and now, as it were, feed upon the crumbs which fall from the manufacturer's table—mending machine-made shoes instead of making shoes to order (as is still done to some extent in England), repairing machine-made agricultural implements, bicycles and automobiles. In some cases where special skill of an artistic character is required, as in the production of hand-made lace, the domestic industry still holds its own against the factory system, as the individual character of the hand-made article appeals to the wealthy consumer much more than the uniform machine-made product. The difference in the excellence of the two methods can be well illustrated from the printing industry, where the type-setting machine has superseded the old hand compositors only within the past twenty years. The solid, uniform reading matter of our newspapers and some of our books is now set by machines with keyboards resembling those of typewriters, but the artistic advertisements seen in our magazines are all "set up" by hand labour, since they involve some artistic skill on the part of the compositor. Thus it appears that there is still some place for the domestic or hand system of industry in our modern civilization in producing goods of peculiar quality demanded by a certain section of the public. By a curious paradox, the very public whose wealth has flowed in largely through the channels of machine industry has acquired an increasingly fastidious taste for the individualised artistic hand-made products. Nevertheless, while there will always be a limited field of this kind for the domestic industry, the great and increasing bulk of industry will more and more be performed by machines.

N.B.—The Canada Year Book of 1907 gives a valuable résumé of the statistics of Canadian manufactures from 1871 to 1906. (Pp. 124-155.) The Year Book of 1910 gives detailed statistics for 1906. (Pp. 36-50.) Industrial Canada, the organ of the Canadian Manufacturers' Association, publishes from time to time interesting and valuable articles on the growth of manufactures of various kinds.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON 5.

1. What do we mean by the "industrial revolution?"

2. What is a factory? Why do people gather together there to produce commodities?

3. Give examples of labour-saving machines, and show how labour is saved by their use.

4. What were (1) the immediate, and (2) the ultimate consequences of labour-saving inventions to the wage-earning classes?

5. Describe the industrial situation of Europe at the be-beginning of the nineteenth century. What causes led to the establishment of the German and American tariff systems?

6. Under what circumstances did Canada get the right to make her own tariff? What general fluctuations have there been in it?

7. What causes led to the establishment of an agricultural implement industry in Canada? Trace its rise and the gradual concentration of production in the hands of a few firms.

8. What causes would you suggest for the growth of the iron and steel industry of Canada?

9. Trace the growth of the textile industry in Canada, using any information upon the subject you can secure from local sources.

10. Trace the rise of the boot and shoe industry. Why do the boot and shoe and the cotton industries appear to flourish most in French Canada?

11. In what type of industries does the domestic system still hold its ground? Give illustrations.

12. Give an account of the rise of any local manufacture (for example, the cement industry) not mentioned in the lesson.

ECONOMICS

LESSON 6

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ECONOMICS

LESSON VI.

Large Scale Production: The Limited Liability Corporation.

IN the last lesson we discussed the rise and the present position of Canadian manufacturing industries. In this lesson we shall deal in detail with the great tendencies which are apparent in the new type of industry.

In the first place, we find that everywhere in manufacturing what is called large scale production is on the increase. The large establishment is absorbing the trade of the small one.

In Agricultural Implements.

This tendency may be illustrated from the case of agricultural implements. We find that in 1901 there were 114 establishments manufacturing agricultural implements in Canada, with a total product of $9,597,389, or a gross average product of $84,187 per establishment. In 1906, 88 establishments had a gross product of $12,835,748, or $145,860 per establishment. There were 26 fewer establishments in the later year, but the product had increased by more than $3,000,000. This change in so short a period is rather remarkable.

In the Cotton Industry.

Again, take the cotton industry, also dealt with in the last lesson. The number of mills in 1906 was the same as that in 1901—20—but the product had increased from $12,033,052, an average of $601,653 per mill in 1901, to $14,223,447, an average of $711,723 per mill in 1906. This comparatively short period of five years has been selected because before 1901 Canadian censuses were not taken on a basis which furnishes figures for such a comparison. In the United States, however, the figures are comparable, and we notice that in 1850 there were 1,094 establishments, with a product of $61,900,000, an average product of $56,581; in 1905 there were 1,154 establishments, with a total product of $450,500,000, an average of $389,948. In other words, the average establishment of 1905 turned out nearly seven times as much work as that of 1850.

In Iron and Steel.

The great American iron and steel industry shows the same condition of affairs. In 1850, 468 establishments had a total product of $20,400,000, an average of $43,589. In 1905, 605 establishments turned out products of $905,900,000, an average product of nearly $1,500,000 per establishment, a figure more than 30 times as great as in 1850.

The tendency towards large scale production evidenced by statistics could be shown to exist in any of the large manufacturing countries of the world. Everywhere during the past half-century in the great manufacturing industries, the size of the individual establishment has been increased, and production, thus concentrated, has come under the control of fewer and more expert "captains of industry" or "entrepreneurs."*

In Transportation.

Nowhere has large scale production been more successful than in transportation—for the transportation agency, as we have seen in Lesson 2, is a producer of place utilities. The progress of large scale production is clearly shown by the gradual incorporation of Canadian railways into the three great systems—the Canadian Pacific, the Grand Trunk (and Grand Trunk Pacific), and the Canadian Northern. There were once many small, independent lines of railway both in Canada and in the United States, but these have gradually fallen into the hands of a few great systems. Greater economic efficiency is the result. The large scale concern can use one of its lines to feed another. It can, like the C. P. R. and the C. N. R., organize great steamship services to feed its railway lines and advertise its route and its attractions throughout the world in a way that would be impossible for a smaller enterprise. Thus to-day the C. P. R. has a continuous service from Liverpool to Hong-Kong, each part of which acts as a feeder of the others.

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*Prof. Bücher, a distinguished German economist, states that the number of employees in establishments having over 50 persons employed increased from 26.3% of the total number of employees in the nation, in 1882, to 36.3% in 1895, and 45.5% in 1907.

Our individual experience also leads us to this conclusion. We have already seen how such great companies as the Massey-Harris Company and the International Harvester Company have superseded the small local agricultural implement manufacturers in Canada and the United States. In business we see the growth of the departmental store, or the growth of the group of stores controlled by one person or one company, like those of the William Davies Company in Toronto and its environs. Generally it seems that large scale production is on the increase.

Growth of Large Scale Production in Canada.

Our conclusion is opportunely corroborated by the results of the Canadian census of manufactures of 1911, when compared with those of 1901. From these it appears that in the year 1900 the number of manufacturing establishments in Canada was 14,650; in 1910, 19,209, an increase of only 31.12 per cent. The product, however, increased from $481,053,375 in 1900 to $1,164,775,532 in 1910, or 142.13 per cent.—a magnificent showing. Dividing the total product in each year by the number of establishments in that year, we find that in 1900 the average product of a manufacturing establishment was $32,836; in 1910, $60,637—an increase of 84.6 per cent. In other words, the average product of a Canadian manufacturing establishment has nearly doubled in the comparatively short period of ten years.

Many Establishments Under one Control.

While this is the case, we must remember that to-day the business unit in many industries is much larger than the single establishment. The Canada Cement Company, for instance, controls from its head office in Montreal the business of various manufacturing plants in different parts of the Dominion. The Massey-Harris Company has also different establishments under its control, as have many great American companies, such as the Standard Oil Company and the United States Steel Corporation or Steel Trust. The concentration in business, therefore, is not to be thought of as fairly represented by the increased size and product of the single establishment alone. Accompanying the tendency to larger production in the individual establishment, there is also the tendency, even greater and more significant, to the grouping of many establishments under one central control.

Advantages of Large Scale Production.

The next question is the cause of this business concentration. As people usually go into business in order to make money, it may be assumed that any phenomenon so widespread as that of large scale production and the concentration of business implies an economic gain to the producer—the business man. Let us now see where that gain accrues.

Economy in Plant.

In the first place, it is a familiar fact that in most industries an increase in the size of the plant reduces the cost of manufacture per unit of product. The value of the site which the manufacturer uses is the same, whether the building he occupies is of one storey or six. The cost of buildings necessary for sheltering machinery and employees is proportionately less in larger plants. The manufacturer can also obtain his motive power more cheaply if he uses a large quantity of it. Thus, in the contracts entered into between the Ontario Hydro-Electric Commission and the various municipalities which are using Niagara power, it is provided that an increase in the amount of power used by the municipality shall be accompanied by a reduction in the rate per horse-power. The reason is simply this: the line once built, extra power can be transmitted at a comparatively small cost.

So, too, in the case of steam. "Both for first instalment and for running expenses," says Taussig, " a large steam engine costs less for each horse-power than a small one; which means economy if the establishment is large enough to utilize all the power supplied."

Economy in Labor

Large scale production is also economic and efficient in its utilization of the forces of its employees. It can keep one man doing one thing all the time, while in a smaller shop he might not find enough to do in that particular branch which suited him best, and might thus have to pass from one kind of work to another at a considerable sacrifice of time and of dexterity. The subdivision of tasks in each employment—such as in the modern shoe factory—is now often called the complex division of labor, to distinguish it from that division of different occupations which is characteristic of the earlier part of the economic history of our country. "In a clothing or in a boot factory," says Marshall, "a person who sews, whether by hand or machinery, just the same seam on a piece of leather or cloth of just the same size, hour after hour, day after day, is able to do it with far less effort and far more quickly than a worker with much greater quickness of eye and hand who was accustomed to make the whole of a coat or the whole of a boot." There we have the reason why ready-made clothing is so much cheaper than custom-made. The United States Department of Labor estimates that there are 84 distinct processes in the manufacture of men's brogan shoes.

Another most interesting example of the division of labor possible under the system of large scale production is quoted by Professor J. R. Commons as occurring in the great Chicago packing houses. "It would be difficult," he says, "to find another industry where division of labor has been so ingeniously and microscopically worked out. The animal has been surveyed and laid off like a map; and the men have been classified in over thirty specialties and twenty rates of pay, from 16 cents to 50 cents an hour. The 50-cent man is restricted to using the knife on the most delicate parts of the hide (floorman) or to using the ax in splitting the backbone (splitter); and whenever a less skilled man can be slipped in at 18 cents, 18½ cents, 20 cents, 21 cents, 22½ cents, 24 cents, 25 cents, and so on, a place is made for him and an occupation mapped out. In working on the hide alone there are nine positions, at eight different rates of pay. A 20-cent man pulls off the tail, a 22½-cent man pounds off another part where good leather is not found, and the knife of the 40-cent man cuts a different texture and has a different 'feel' from that of the 50-cent man. Skill has become specialized to fit the anatomy. . . .

"The division of labor grew with the industry, following the introduction of the refrigerator car and the marketing of dressed beef, in the decade of the seventies. Before the market was widened by these revolutionizing inventions, the killing gangs were small, since only the local demands were supplied. But when the number of cattle to be killed each day increased to a thousand or more, an increasing gang or crew of men was put together; and the best men were kept at the most exacting work." This illustrates the advantage secured by so dividing work that expert labor is employed only where necessary, while cheaper labor is used wherever possible.

Economy in Supervision.

Furthermore, by large scale production the expense of oversight is reduced to a minimum. One superintendent and one foreman can direct the industry of a larger number of men than are actually employed in a small establishment; one timekeeper, one watchman, and one engineer can usually serve a large establishment as effectively as a small one. Men must be employed in all these capacities in a factory of even moderate size, hence the advantage of distributing their cost over as large an amount of production as possible. At times when competition is keen, such economies as these may make to a business all the difference between success and failure.

Economy in Buying and Selling.

In buying and selling also the large scale establishment usually works to better advantage than the small. It can buy in bulk the raw material necessary for its business, and thus secure it at a price lower than that charged for small orders. Its very size and the strength of its financial position enable it to survive a crisis which would wreck a weaker firm. It does not have to put its product on the market at an unfavorable time. It can manufacture for its stock, store its goods and dispose of them only when conditions have come back to normal.

With all these natural economic advantages, it is no wonder that the large scale establishment has to a great extent superseded the small scale firm in the industry of the country. This is generally the case, even when the legitimate advantages of which we have spoken are not reinforced by illegitimate and monopolistic control of the market. Yet this increasing predominance of large scale production is not without its exceptions—those exceptions which prove the rule. Of these the most important is agriculture.

Agriculture the Great Exception to the Rule.

The United States Statistical Abstract for 1911 shows that, while in 1890 the area of the average farm in the United States was 136.5 acres, in 1910 it was 138.1 acres—practically the same. In Canada during the same period the average area has probably increased, owing to the opening up of the West, where farms are larger than in the

Eastern Provinces. But even in the farms of the West we do not find the same general tendency to large scale production as in the industries of the cities. A farm employing ten men would be considered a very large farm, but a factory with that number is certainly a small factory. And the tendency, as was shown in Lesson IV., is for the labor force on farms to decline rather than to increase in numbers.

There have been large farms in the history of the American continent—the plantations of the Southern States and the "bonanza" wheat farms of the West. But the former have passed away, and the latter are, in the majority of cases, being broken up into smaller areas. This large scale production in agriculture is found usually where the land is quite unused and where one crop—wheat or rice or cotton or sugar—can be grown on the same soil with very little cultivation year after year. When the fertility of that soil becomes exhausted it is abandoned, new soil is taken into cultivation, and the same methods are applied to it. Large scale cultivation is profitable only as long as the soil can be thus "mined," as it is called. When it no longer responds to this treatment, but requires to be "nursed" and treated with fertilizers, then it is to the public interest that it should pass into the hands of some small proprietor who will farm it carefully with a view to its permanent value.

"The magic of property," it is said, "turns deserts into gardens." If a man feels that a piece of ground with all its potentialities is his very own, he will put an enormous quantity of labor and thought into its improvement and cultivation. On the plantation or the "bonanza" wheat farm, the actual cultivator does not feel this passion of ownership, and the manager cannot know as well as the actual cultivator the characteristics of each field and for what crops it is best fitted. Further, the superintendence of a large farm is a very difficult piece of business, since the activities of the establishment are spread over such a large area and are so varied in their character.

On the farm, then, large scale production has not on the whole increased, because it is usually inefficient and uneconomic—and especially so after the country becomes at all well settled, since it is no longer impossible for the owner of the large scale farm to exhaust one piece of soil and move on to another. In some sections of the country, where large tracts of land were once carelessly farmed, the soil has become exhausted and full of weeds, and will respond only to careful and fairly skilful cultivation. Hence these large farms are being broken up into smaller holdings and what is known as "intensive" farming—the careful, scientific cultivation of a comparatively small area—is on the increase.

Retail Stores a Partial Exception.

Somewhat similar to the case of agriculture is that of the small retail store, which often survives obstinately in spite of the growth of departmental stores and of great mail order establishments. The reason for its survival is, perhaps, somewhat similar to that for the survival of the small farmer. Just as the latter knows better than anybody else his land and its capabilities, so the former knows his locality and his individual customers better than the great storekeepers can know them. He goes to the same church and the same lodge as they do, he understands their individual likes and dislikes, and adapts his goods to their individual tastes. And since the personal element still counts for a good deal with the average retail customer, so the retail merchant who has this hold on the customer manages to survive in a competition where most of the great economic advantages seem to be on the side of the departmental store. The small grocers in the residential districts of cities survive because they are more conveniently situated for the customers and study their tastes more than can the departmental stores.

Conditions of Large Scale Production.

In general, as we have seen, though with a few important exceptions, large scale production has been gaining ground on small scale production. For this large scale production to arise, certain primary conditions are requisite. There will, of course, be no possibility of large scale production unless there is a considerable demand for the commodities in question. This goes without saying. A condition not so obvious, but just as essential to large scale production is a large investment of capital. In some cases the investment required is enormous.

For instance, an expert witness told the United States Industrial Commission that to equip an up-to-date iron and steel manufacturing plant large enough to secure the economic advantages arising from the division of labor would require an investment of from $20,000,000 to $30,000,000. Who is there that has so much money to invest? And would such a fortunate individual be likely to risk the loss of his great possessions by investing all his capital in a single steel plant which might well be undersold and ruined by an even more gigantic body, such as the United States Steel Corporation?

Limited Liability Companies.

The enormous investment of capital required by modern large scale production is then rarely, even in these days of millionaires and multi-millionaires, provided by one or even by a few persons, though a small group of persons may undertake to finance the concern, *i.e.*, advance the necessary funds, trusting that the public will buy stock later. The great manufactures, the great transportation lines of to-day are operated by joint stock companies, often with thousands of shareholders. The Standard Oil Trust, for example, had at the time of its so-called dissolution, when its affairs came into the limelight, about six thousand shareholders. The Steel Trust has, I believe, a much greater number.

An Expanded Partnership.

These joint stock companies are a sort of expansion of the older partnerships. We all understand that three or four men may join their resources and go into a business together. Some of them may be silent partners, simply investing their money and receiving periodically a share of the profits earned or sharing the losses incurred. Others may be active partners, receiving a salary for their personal services as well as sharing in the profits or losses. Now, if such a partnership business goes into bankruptcy, perhaps through the defalcation of one of the partners, each of the other partners is liable to the full extent of his property if so much is needed to satisfy the creditors of the concern. This is what is called an unlimited partnership. No matter how many partners are in a concern, every partner is liable for the full extent of the concern's liabilities. Until modern business methods arose in the nineteenth century, it was rarely that the Government allowed the shareholders of a business enterprise any limitation of liability.*

An Unlimited Liability Corporation

What this theory leads to when applied to corporations doing a modern business is illustrated by the case of the City of Glasgow Bank, which failed with enormous liabilities in 1878. (This failure is well described in Sykes' edition of "Gilbart's History, Principles and Practice of Banking," Vol. II., pp. 364-390.) At that time three of the older Scotch banks were under the system of limited liability, the other banks of Scotland under unlimited liability—that is, every shareholder, just like a partner in an ordinary business, was liable to the full value of his property for all liabilities of the bank. When the City of Glasgow Bank failed the shareholders thus found themselves liable for all the debts of the bank. As a result the majority of them were ruined, as the calls upon them amounted in the aggregate to £2,750 for every £100 share held by them. As a natural consequence there was widespread consternation among the shareholders of other similar banks, and the price of shares declined greatly. No one wanted to invest any money in shares which might involve him in a liability of possibly twenty or thirty times the amount of his investment in case the enterprise failed. The country realized that it was impossible for the banks to continue to exist upon this basis, and in the following year the law was amended so as to allow all banks to register themselves under the Companies Act,* and thus become limited liability corporations. This was absolutely necessary if banks' shares were to attract investors, as no one wanted to be a shareholder under the previous perilous conditions. The double liability imposed upon our bank shareholders by the Canadian Bank Act is a relic of the older system.

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*There were some exceptions. Typical cases of these are the Bank of England and the East India Company. The former was given special privileges because it loaned money to the Government; the latter because of Charles II.'s desire, on his restoration in 1660, to conciliate the great merchants of London.

This case of the City of Glasgow Bank illustrates the injustice of holding shareholders responsible with their whole property for the debts of a business over the conduct of which they can have no constant supervision and control. In a small partnership consisting of say three members, it may be reasonable to hold each of them fully responsible for what the others do, but in a great modern enterprise with thousands of shareholders, often widows and orphans who know little or nothing about how the business is being carried on, it is quite unreasonable to claim that they should lose their whole property because of some investment made perhaps years before and almost forgotten by the investor. Such an investment may even have passed by bequest from the hands of the original investor into those of persons who may be ruined instead of benefited thereby.

Thus we have to-day the principle of limited liability in large corporations everywhere adopted. For great modern enterprises an enormous amount of new capital is required. The savings of comparatively poor men amount in the aggregate to far more than the accumulations of the millionaires, and it is from this source that the bulk of new capital must be raised. Consequently those who are desirous of raising capital issue stocks and bonds which appeal even to the poor man who has only a little money to invest. Thus to-day many companies issuing bonds issue them in $100 units, while only a few years ago they usually issued their bonds in $500 or $1,000 units. The raising of capital is facilitated by the fact that the investor, except in the case of the double liability of banks, can in no case lose more than the actual amount of his investment.

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*In such a course as this it is unnecessary to trace through its various stages the progress of the movement in favor of allowing the free incorporation of limited liability companies in the business world. The influence of that movement was naturally first felt in the country industrially most advanced—Britain. Its triumph was a slow process. The gradual extension of the principle of limited liability can be traced through different Acts of the British Parliament passed between 1826 and 1879.

Growth of Limited Liability Corporations.

The growth of limited liability corporations in business is stupendous. In 1909, according to a report submitted by the Commissioner of Internal Revenue to the Treasury Department of the United States, the corporations doing business in that country had issued capital stock to the amount of $57,886,000,000 and bonds to the amount of $30,715,000,000. Making all due allowance for stock and bonds issued below par, it is probable that the actual investment in these corporations is at least $60,000,000,000, or about $3,300 for every family of five persons in the country. About half the total wealth of the nation is thus held by these corporations, or rather *through* these corporations, for it should not be forgotten that the shareholders are the owners of these corporations and that their number is legion.

Advantages of Limited Liability.

The limited liability company has been of great use to the world during the comparatively short period of its predominance. It has enabled all sorts of people, professional men, widows, orphans, etc., to invest their savings in commercial enterprises and to share the profits of businesses of which they know little or nothing. Unlike the partners in the old-time business, they are able to sell their shares through the stock exchange at any time when they begin to distrust the future of their investment or when they need the money. It has provided the capital for daring and adventurous undertakings, for achievements which are reckoned among the glories of our age, capital for which could not have been secured if the investor were liable beyond the amount which he actually paid for his shares. Who would have invested, for instance, in the first Atlantic Cable Company, in the Marconi Wireless, in the Bell Telephone, or even in the C. P. R. at their beginnings, if the failure of these various schemes, the risk of which he had to take, had involved him in an unlimited liability for all the debts contracted by these enterprises? No one who realizes the many advantages arising from the working out of this principle in modern business life would think of a return to the old system of unlimited liability.

Disadvantages of Limited Liability Corporations.

The limited liability corporation, while a necessity in modern business, is by no means an unmixed blessing to society. It has brought with it its peculiar type of evils, though they do not nearly offset its advantages.

Chief among these is the immense waste of capital in the organization of what are called "wild-cat" companies, such as are many of the mining companies of to-day. The investor, or rather speculator, too often prefers the chance of large profits to the six or seven per cent. obtained by investing his savings in more stable and legitimate enterprises. In the aggregate, it is said, the investing public has put more of its savings into Cobalt than it will ever get out.

Again, nothing is commoner than for a skilful promoter to buy a business for say $500,000, capitalize it at $1,000,000, sell the shares for $750,000, and pocket a quarter of a million on the transaction. The business is then expected to earn profits on $1,000,000 capitalization, when the actual investment is only half that sum. Various nations, notably Germany, have tried to prevent such transactions by requiring that the actual investment in the company shall be the basis of its capitalization.

On the whole, people probably paid more attention to the character of their investments when these involved them in an unlimited liability. Nevertheless, the almost phenomenal growth and achievements of the limited liability company show that its existence is in harmony with the trend of modern commercial development, and it is undoubtedly a factor of permanent and increasing importance.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON 6.

1. Give statistics showing the increase of large scale production in Canadian and American manufactures.
2. What reasons would you give for the increase in large scale production in transportation arising through the consolidation of railroads into a few great systems?
3. Secure from some local source figures illustrating the economy in cost of plant and power due to large scale production.
4. Give the facts of the situation in the Chicago packing houses to show the economy of labor in large scale production. Can you find a local parallel?
5. What advantages has the large scale producer over the small scale producer in purchasing raw material and selling the finished product?
6. Discuss the exceptions mentioned—agriculture and retail stores. Why do the exceptions persist?
7. Do you always buy goods of various kinds at the place where the price is lowest? What other motives influence your choice?
8. Illustrate the dangers of unlimited liability in modern business by reference to the case of the City of Glasgow Bank. What do you think of our double liability? Illustrate by the Farmers' Bank case.
9. Trace the rise and discuss the necessity of the limited liability company in modern business.
10. Discuss any disadvantages of limited liability corporations.

ECONOMICS

LESSON 7

By

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TORONTO, - CANADA

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ECONOMICS

LESSON VII.

Exchange

THE problems connected with exchange—*i.e.*, the voluntary giving of one commodity or service on condition of receiving another—are among the most important with which we shall have to deal. They will form the subject of the next four lessons, VII., VIII., IX. and X.: the present lesson deals with the general problems of exchange; the eighth with money, the medium of exchange; the ninth with credit exchange—banking; the tenth with the laws of international exchange or international trade.

The importance of exchange as a division of economics may be realized in a moment by supposing all exchange of commodities at an end. In such a case, each individual would have to produce for himself everything that he needed, with the result that we should all find ourselves living like savages, since none of us could produce for himself more than would satisfy the most elementary cravings of his physical life—food, clothing and shelter. Even these needs would be only miserably satisfied, while all the higher needs of mankind would go entirely unappeased. So in his economic life, as elsewhere, man is, as Aristotle says, a social, a gregarious animal. He who lives to himself alone is *ἢ Θηρίον ἢ Θέος*—either a beast or a god—less or more than human.

Rate of Exchange of Commodities.

The exchange of commodities is, then, a primary necessity of civilized life. The next important point is that of the exchange value or the *rate* of exchange—the amount of any one commodity which it is necessary to exchange in the market for a given amount of another, and the laws by which that amount is regulated by supply and demand (see Lesson I.) under various conditions of life. (Here the student may either exclude money from consideration altogether, or he may, as he is perfectly justified in doing, treat it as a single commodity—gold, since our dollar is simply 23.22 grains of pure gold.)

This great problem of the rate of exchange of commodities against each other, or against money, has become enormously complicated under modern conditions of living, where the prices of at least the staple commodities are decided in a world-wide market. The student will find it far easier to grasp the main points if he allows himself to be mentally transported to some small market* such as was furnished by the mediaeval town and its surrounding district, or such as might still be furnished by some remote, self-sufficing community of to-day. He should also refer to the latter part of Lesson I., a knowledge of which is taken for granted.

Competition in a Small Market.

Suppose, then, that in some such isolated place where communication with the outside world is exceedingly difficult, and there is practically no need to consider importation, four persons—A, B, C, D— are the sole producers of a given commodity—hats, for example. Under such conditions each of the competing hatters would be trying all the time to allure customers to himself from the others. He would do so by attempting to give them more for the same money or the same thing for less money than his competitors, or at least to make them believe he was doing so.

How would this be possible? For one thing, he might work harder and thus turn out a greater product per annum than his competitors, and thus his labor cost per unit of product would be less. Secondly, he might keep his living expenses down below theirs, and thus be able to subsist on a small margin of profit. Thirdly, he might use some labor-saving machinery not used by his competitors, and thus turn out more hats in a shorter time. Fourthly, by shrewdness of bargaining, or by being able to pay cash, he might buy his raw material for less than the others.

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*A market, in the economic use of the word, does not mean any particular place where buyers and sellers higgle over the prices of commodities; it means the process of higgling between all the buyers and sellers of a commodity, as a result of which a normal market price for the time being is finally reached.

Marginal Producer and Producer's Surplus. Normal Price.

In all or any of these ways, then, it would be possible for the keenest of the four competitors to undersell or seem to undersell his rivals. Suppose that A, the most efficient of the four hatters in the community we are considering, is able to make a living by selling his hats for $1.50; B, by reason of lack of capital or machinery, or perhaps of personal skill or industry, finds he cannot make ends meet if he sells for less than $1.60; C, a still less efficient producer, cannot afford to sell his hats for less than $1.70. These three, however, cannot, even when working at their utmost speed, manufacture as many hats as the consumers of the community require and are willing to purchase at a price remunerative to the producer. The supply is not equal to the demand. So we have a fourth producer, D, called into activity, who, on account of still greater inefficiency, cannot make a living wage unless he is able to dispose of his hats at $1.80. The community's demand is just sufficient to purchase his product at $1.80, and thus at last we find supply and demand in equilibrium.

There is probably in the community some other person, E, who could produce hats for $2.00, but as a sufficient supply can be obtained at $1.80, the community will not pay more than that. Thus $1.80 is the *normal market price*—the price at which with the present demand a sufficient supply can be obtained. But the others are not going to sell their hats for less than the price D is able to get—*there is only one market-price for the same commodity in the same market at the same time.* D is what we call the *marginal producer—i.e.,* the one who produces so inefficiently that he can just make a living at the market price. A, B and C meanwhile, who are able to make a living when selling their hats at $1.50, $1.60 and $1.70, are now, at the market price of $1.80, making an extra profit of 30, 20 and 10 cents respectively on each hat sold. This profit is often called *producer's surplus,* inasmuch as it represents the advantage of each of the other producers per unit of product over that producer who can just keep in business at the normal market price.

Normal Price.

The normal price under the conditions which we have depicted is, then, $1.80, because at that point the demand for hats is just equal to the supply, or, as the economist puts it, supply and demand are in equilibrium. Suppose now that a considerable influx of immigrants occurred, and that among these immigrants there were no hatters. The result would be that the demand for hats would be increased while the supply would remain stationary; those who were not ready to pay $2.00 for a hat might not be able to procure one. If the new normal market price were $2,00, E would be able to begin manufacturing hats. Again, new hatters might come into the community who could produce an abundance of hats. The competition of the newcomers would naturally drive prices down, and this lowering of prices would stimulate the demand for hats, as under the law of diminishing utility* a consumer might consider a hat worth $1.50 to him which he would not buy at $1.80. It might be possible to dispose of all the product by a drop of prices to $1.50, which would become the new normal market price. To put this briefly, the normal market price is that at which supply of and demand for commodities are equal; where demand is increased while supply remains constant, that demand is checked by an increase in the normal market price; where supply is increased and demand remains constant, that demand is stimulated by a drop in the normal market price.

So far all our argument presumes the existence of free competition between buyers and sellers. The buyers are at liberty to buy as cheap as they can, and the sellers to sell as dear as they can. And while $1.80 is our normal market price, that does not necessarily mean that every transaction is closed at that price. A keen buyer may easily get his hat for 5 or 10 cents less. A keen seller may easily secure 5 or 10 cents more by taking advantage of his ability in bargaining, just as on the stock exchange slightly different prices are often paid for the same stock at almost the same moment. The actual price, however, approximates closely to the normal price.

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*See Lesson I.

Advantages of Free Competition.

Free competition means on the whole an economic gain and was considered by the older economists an exceedingly beneficial state of affairs. Their view was that under free competition the price of everything would be forced down to the minimum, and that all producers would always be desirous of producing as efficiently and cheaply as possible in order to undersell their competitors and to let the consumer have his goods at the lowest possible price. "Competition," they said, "is the life of trade." It kept everybody hustling to adopt the latest labor-saving method of production. Thus the consumer derived the ultimate benefit. From the consumer's point of view—and economists are in the narrower sense of the word consumers rather than producers—nothing could be more admirable than the process of keeping the producers of commodities on the jump to supply all their wants at the lowest possible price.

Disadvantages of Free Competition.

Unfortunately, competition has not all the virtues claimed for it by its enthusiastic advocates. Even perfectly legitimate means of gaining advantages over one's rivals may be pushed to excess. Greater speed in production may and often does lead to carelessness in workmanship—the article being got up to sell, and the seller quite oblivious of the fact that such an article might last only half as long as the better product of other makers. Secondly, one manufacturer may use poorer material than his competitors and thus produce an article which looks "just as good" as theirs, but is not. He may use cheap "shoddy" to make a hat just as others use it to make clothes. In a word, he may adulterate his product.

Adulteration, as our analysts tell us, is exceedingly common, occurring in manifold forms, such as the using of chicory in coffee, of shoddy in the manufacture of clothes, etc. It may result in gain to the adulterator, but it certainly does not result in gain to the general public, and may, therefore, be described as illegitimate competition from the public's point of view. Some economists have, however, defended it, and John Bright protested against an anti-adulteration law on the ground that it interfered with freedom of competition, saying that the purchasers of such commodities should be forced to look out for themselves.

Another means of getting trade away from one's neighbor is by advertising in various ways. No doubt a certain amount of this is necessary to put the merits of one's goods before the public, but only too often that advertising, as is often the case with patent medicines, unloads worthless goods upon the public. The advertising bill is probably the largest that most patent medicine manufacturers have to pay. But for all advertising, whether of meritorious goods or of trash, the public has to pay the cost in the long run. It is a charge upon all industry, and some part of our present high prices is no doubt due to the increase of advertising.

Decline of Competition.

One of the leading phenomena of modern economic life is the decline of free competition in many important industries in which either one great organization—a trust—has secured control of the industry, or a number of producers —a pool—have come to some agreement which limits their competition in various ways, as by refusing to sell below a certain fixed price. To show how such a state of things arises, we will revert to our former illustration.

How Competition Declines.

One of the hatters, who by hard work and forethought, we will say, has got ahead of the others, finds himself able to save money. He has got his advantage in one or more of the ways which we have described, and by giving better values to his customers has so increased his sale of goods that his aggregate profit is more than before. He finds himself, then, in a fairly comfortable position; his income is considerably higher than his expenditure, and he thus has money to invest. If, as his previous record indicates, he is an ambitious person, he will turn his savings into his business, in order to make his plant more efficient, and to secure the advantages detailed in the last lesson as proceeding from large scale production. Then, producing on a larger scale than his competitors, he will be able to manufacture much more cheaply than they, and will be able to sell his goods at a price at which they are unable to compete. In this way, then, he may gradually get control of the hat trade of the community. The weakest hat maker, who has least technical and business skill, may find it impossible to make a living in the business at all—possibly he may become an employee of his more successful rival. The other two, we will say, survive with difficulty, just managing to exist on the new lower prices which have been set for the community by the large scale producer.

Time goes on. The first manufacturer becomes keener and keener for enlarged profits, but, strong as he is, he does not venture to raise prices and drive people to trade with his still struggling competitors. Others also might find it profitable to enter the industry if he were to put up the prices. So things go on for a time, until finally the happy thought strikes him: "Why not buy out the others? They will sell out cheaply because they are making so little money. Then I shall be in sole control of the market and may put prices where I please." So he tries this scheme, if he has the ready cash to put it through. If he has not, then he may amalgamate the three industries into a company, of which the other two perhaps receive cumulative preferred 7% stock for their property, while the large manufacturer has the controlling voice on account of his ownership of a majority of the stock.

Monopoly.

Now, then, we have a monopoly established in our community, so far as the manufacture of hats goes, at least. What is our manufacturer going to do now? and where is he going to fix the prices, since he has the only factories equipped for hat-making, and it is, by hypothesis, impossible to import them from outside? He has complete control of the supply.

Limitations of Monopoly.

Our manufacturer is anxious to make as much as he can, but he cannot drive the price too high or else the common people will give up wearing hats altogether. These may become a mark of wealth and distinction, like automobiles. But such a course would not pay him, because in every community the comparatively poor are far more numerous, and in the aggregate buy far more largely of such articles as hats than do the wealthy. It is not our manufacturer's object to make the most possible on each individual hat, but to make the greatest aggregate profit on his whole product. He might be supposed to know already just about how many hats the community will take at each price, but if he does not he will have to experiment by raising and lowering the prices and calculate what price gives him the greatest aggregate profit. His calculation might run about as follows:

At $10.00 I can sell 3,000 hats costing $1.60 each; net profit on each hat $8.40; or..............$25,200

At $5.00 I can sell 10,000 hats costing $1.50 each; net profit on each hat $3.50; or.............. 35,000

At $4.00 I can sell 20,000 hats costing $1.40 each; net profit on each hat $2.60; or.............. 52,000

At $3.00 I can sell 32,000 hats costing $1.30 each; net profit on each hat $1.70; or..............$54,400

At $2.00 I can sell 50,000 hats costing $1.20 each;
net profit on each hat 80c.; or................$40,000

Fixation of Monopoly Price.

Our manufacturer, then, experiments with the above results, and after thoroughly testing what he can sell at the various prices places the price at $3.00 and keeps it at that until $3.00 becomes recognized in that community as the customary price for a hat.

From this we may derive the general conclusion that when an individual or a group of men acting together are in control of the supply of an article, the price at which they will sell it will be that at which the total aggregate profit to themselves will be greatest. They will not put the price extremely high, because then ordinary people will try to find some substitute, if the article is not absolutely indispensable to life; the demand at the high price will be slight, the sale will be small, and, although the profits on each article sold will be large, yet they will not total as much as if a lower price had been set and a greater number of articles sold. In order to sell on a very large scale, the monopolists must, as a rule, be content with a fairly moderate price per unit of product. They cannot usually force goods on a consumer who does not find it worth his while to buy them. His demand and the price which he is willing to pay is governed by the utility of the article to him, and, as we have seen in Lesson I., this utility is a diminishing utility—it decreases with every increase in the amount of the article which he already has.

The manufacturer seems now to be in a very enviable position, raking in large profits from the sale of the articles which he controls. But to some extent at least he is a colossus with feet of clay. Selling hats at $3.00 which cost him only $1.30 to produce, he is never sure that some new man may not commence manufacturing the goods and cut into his very profitable trade. There is no law against it. The

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*The decline in cost of production here shown is owing to the saving due to large scale production.

new man is just as much entitled to carry on the hat-making industry as the monopolist.

How the New Competition is Crushed.

Suppose such a case occurs. A bright young man of small capital, but considerable technical skill and business ability, begins to manufacture hats, selling them at $2.50. The monopolist cuts his price to $2.25, his rival to $2.00. The monopolist makes a further reduction to $1.75, and his rival then offers his hats at $1.50. This we will suppose is rock-bottom price for him, as he manufactures only on a small scale. The monopolist can, however, go on down to his manufacturing price of $1.30 or so. If the rival has only small capital he is apt to be ruined; if he has large capital and can stand for a considerable time the strain of manufacturing without a profit, then the monopolist will get tired of the game and the result will in all probability be some sort of arrangement between the two as to prices and quantities to be sold at those prices. Or perhaps the younger man may be taken into the monopoly, receiving stock for his interest in his factory.

Thus the monopoly or single control of the industry would be restored, and the consumer would again have to pay the monopoly price for the commodity. But it should be remembered that still another rival may arise at any moment and, if reasonably well provided with capital, may make considerable trouble for the monopolist, though in the end he is likely to be ruined or forced to sell out to the monopoly.

Greater Power of the Large Monopoly.

This is still more likely to occur when a monopoly holds the trade of a hundred communities and some local competitor begins business in one of them. Then the monopoly can easily afford to sell at a loss in that community (perhaps recouping itself by higher prices in the others), crush its competitor, and then raise its prices again to their normal level. Of course, if the new rival has capital sufficient to enable him to compete in all or most of the markets of the older company at once, it will be impossible to dispose of him so easily. In such a case the result will probably be the amalgamation of the two concerns, or at least a working agreement between them not to sell at less than a certain fixed price. This would in practice have the effect of perpetuating the monopoly.

Monopoly Price Not Necessarily Higher Than Competitive.

Our analysis probably fairly covers the situation with regard to such a commodity as hats under competitive and under monopolistic conditions. But the student must remember one thing—there is no absolute necessity that a monopoly price for a certain article will be above the competitive price for the same article in the same market. In the case of competition, as we have seen, the price must be sufficient to equal the cost of production of the least efficient producer whose product is needed by the community in question. The monopoly, however, is, because of the great advantage of large scale production, the most efficient producer rather than the least, and it may pay the monopoly to fix its price at a figure which makes its profit per article less than the producer's surplus of the most efficient over the least efficient producer. By doing so it may make the largest possible aggregate profit, because of the enormous demand induced by the low price of the article which it controls. Some people claim that Standard Oil is in this position—that its prices are less than those which would be necessary if the old wasteful competitive system prevailed. This is very much a matter of opinion. What is certain is that the price of oil is lower than it was under the old competitive system—lower because of the great improvement in the production and transportation of oil. But we cannot be sure that if competition were restored to-day under these improved conditions, the price of oil would not be lower than it is. It is probably rarely the case that monopoly price is less than competitive.

Distinction Between Competitive and Monopoly Price.

So far we have dealt in the main with a small isolated community, and we have found that the price of a commodity, when free competition prevails, is likely to be equal to the cost of production of that commodity when manufactured by the least efficient producer actually employed; other producers have a lesser cost of production per unit simply because they are more skilful or have larger and better equipment, and these favored persons selling the same article for the same price—because one article cannot have two prices in the same market at the same time—secure a producer's surplus—the difference between their lower cost of production and the higher cost of production of the least efficient producer.

Under monopoly, on the other hand, the price tends to be that which gives the monopolist the greatest aggregate profit. In a small community, as we have seen, he will be able to experiment and find out approximately what that price will be.

Difficulty of Predicting Supply and Demand.

In practice, the fact that for most commodities to-day our market is a world-market greatly complicates our problem. It is not merely the hat-makers of a single community who are in competition—it is the hat-makers of the whole world. And who is going to tell the hat-makers of Toronto or Montreal how many hats will be manufactured or are going to be needed at a given price throughout the world in a given space of time—say a year? In the modern world our competing hat-makers go on producing blindly, with only the roughest general ideas as to the state of the market. And none of them can tell, unless he has a contract signed for the purchase of his product, what he will get for that product in the market. It is clearly impossible for one small competitor in one corner of the world to gauge what the world's demand in a given time is likely to be. And while he may be able to save up his hats if there is no immediate demand for them, yet the fact that the next year they would be out of fashion would make it impossible for him to sell them for what they had cost him. Fashion is a disturbing factor with which the makers of clothes have to reckon.

The producer of an absolutely staple commodity—a commodity that is always usable, like wheat, or still more, gold—is in a somewhat better position. If his product is not purchased at a fair price one year, he can keep it until the next—in the case of wheat, with considerable cost for storage and loss through shrinkage of the grain; in the case of gold, with practically no expense except that for safekeeping. In the case of our food products, the quantity of which is largely dependent upon nature, a good year is thus used to balance up a poor one, with the result that prices in the good year are a little higher than they would otherwise be, while in a bad year they are lower than they would be if only the crop of that year were available for consumption.

The same thing happens in regard to fruits. With equal crops and equal demand, prices are higher at the height of the season and lower out of season than before the invention of cold storage. At the height of the season, when fruit is exceedingly plentiful and is sold, as the saying runs, for a song, the cold storage people take a considerable portion of it out of the market, thus lessening the supply and increasing the price. On the other hand, fruit is now cheaper out of season, because the cold storage companies are letting it out of storage at a moderate rate compared with what was charged when it had to be imported from some distant land.

These considerations greatly modify the rigidity of our conclusions. What producer or what consumer is able at any moment to say with knowledge of the supply of or the demand for a given commodity at various prices, just what the normal price of that commodity will be? On the whole, all one can say is that the local market price tends to be the same as the normal price at the chief centre of distribution, less the cost of transportation. Thus the price of wheat in the United States and Canada long tended to be equal to that in Liverpool, less cost of transportation. This was the case so long as both the United States and Canada exported large quantities of wheat to Liverpool, but is scarcely so now, as the United States consume nearly all their product. On the whole, one may say that a great staple commodity such as wheat tends to conform more strictly to the normal price in a competitive market than other commodities, because wheat is so important to the race that information about the condition of the wheat crops of different countries is very widely diffused. The demand for it is also fairly constant, or rather increases approximately in proportion with the growth of population of the wheat-eating countries. Wheat is not likely, in our time at least, to go out of fashion.

Concentration of Trade.

As the trade of the world in its great staple commodities is passing into fewer and fewer hands and centering in a few great communities such as London, Paris, New York and Chicago, we may expect to find demand and supply more accurately calculated by those who are at the centre of affairs. These men will be all the time receiving messages as to the state of supply and as to the conditions influencing demand in various parts of the world, and they will more and more "make" the market price on the basis of a consideration of supply and demand. They may do even more. They may, like Standard Oil, embrace the whole world with their organization, and may be able to dictate to the world a market price higher than the normal competitive price—a monopoly price which will bring them the greatest possible aggregate profit.

On this subject students are strongly advised to read Frank Norris' novel, The Pit, which may be obtained at most public libraries. It is published by Nelson and may be secured (from Toronto booksellers at least) at the very moderate price of fifteen cents, plus postage.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON 7.

1. Mention ways in which a merchant may attract customers from his competitors. Which of these bring gain to the public? Which do not?

2. Explain clearly what is meant by normal market price? Marginal producer? Producer's surplus?

3. Why does demand increase when prices fall?

4. Illustrate from your own experience the economic advantages of free competition.

5. Show clearly how out of a state of free competition combination and monopoly may arise.

6. How is it possible for a monopoly to maintain itself in an industry which anyone is free to enter?

7. Explain the way in which the holder of a monopoly regulates his prices.

8. Suppose a monopolist knows in advance the demand for his commodity at different prices and its cost of production when produced in those quantities, where would he fix the price in the following:

Demand.	Cost.	Profit?
10 at $1,000	10 at $500	
20 “ 800	20 “ 460	
30 “ 700	30 “ 450	
40 “ 600	40 “ 430	
60 “ 500	60 “ 425	
80 “ 450	80 “ 420	
100 “ 400	100 “ 415	

9. What makes it impossible for the man who opens up a small local oil well to compete with Standard Oil for the trade of his locality?

10. Is monopoly price always higher than competitive? Discuss fully.

11 What determines the price which our farmers get for their wheat?

ECONOMICS

LESSON 8

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ECONOMICS

LESSON VIII.

Money—The Medium of Exchange.

EXCHANGE was originally carried on by means of barter—that is, the giving of one commodity directly in exchange for another. In this case the one party gives something which he has in excess for something else which he needs, and of which the second party has more than he wants. The second party must also be desirous of what is offered by the first.

The great disadvantage in exchange as carried on under the system of barter, is that a producer of a certain commodity will have to waste a great deal of his time in searching for people who both want his surplus product and are ready to give him what he wants in exchange for it. This great difficulty has been overcome, this waste of time avoided, by the introduction of a third commodity, which serves as a medium of exchange—a money. The exchange value of a commodity, as measured in terms of the commodity which is used as money, is called its price.

Medium of Exchange.

Many commodities have at different times in the history of civilization been used as money—as media of exchange. In an early stage of civilization like that of the patriarchs of the Book of Genesis, cattle were used as money; (our word pecuniary is derived from the Latin pecus, a herd). The negroes of Africa still buy their wives with cows. Wampum was used as money by the Indians, beaver skins by the traders of Hudson's Bay, tobacco by the planters of Virginia, and various other articles have been used as money in different parts of the world. But to-day in practically all the civilized countries of the world, gold and silver money have replaced all other kinds. The reason for this will be seen later.

In addition to and growing out of its use as the medium of exchange, money has two other important uses: a common denominator of values, and a standard of deferred payments.

Common Denominator of Values.

Money acts as a common denominator of values; that is, instead of expressing the value of various articles in terms of each other, instead of saying that so much copper is worth so much tin, and so much lead is worth so much iron, and so much wheat so many pounds of beef, we can express the value of all these things in terms of money. And, knowing their value in money, we can easily deduce their value in terms of each other. We measure value by money, just as the tailor measures the length of a piece of cloth by the yard-stick.

Standard of Deferred Payments.

Money also serves as a standard of deferred payments, because its value is—or should be in a good money—more constant than other values. If our standard of deferred payments were potatoes or grain, a debtor would naturally borrow these articles in the spring when they are scarce, and pay his debt in the autumn, when they are abundant. The result of this would be that no one would want to lend, because the value of the potatoes or grain which he would receive in the fall would not be equal to the value of those he had lent in the spring. (Remember that value depends only on utility and scarcity, and the value of an article that is scarce, as compared with the demand for it, is naturally higher than that of an article which is plentiful.) So, then, the creditor would be cheated if a loan made in spring were repaid in autumn, while the debtor would get the worst of it if a loan made in autumn had to be repaid in spring. Even if loans all ran for a year, the creditor would lose if he made a loan at the harvest of a scarce year and received his grain or potatoes back at the harvest of the following abundant year. If lending and borrowing is to go on—and it is for the great benefit of us all that they should go on—our standard of deferred payments must be stable in value, unfair neither to debtor nor to creditor, or at least as fair as is possible to both.

Qualities of Money-Materials.

Economists, then, have agreed that in order to be good money-materials (materials out of which money can be made) articles ought to possess the following six qualities:

(1) **General Acceptability.**—They must be such that all men desire them, even apart from their use as money.

(2) **Portability.**—They must be easily transferable from place to place, so that a man can take the money which he has received for some commodity anywhere he may wish, to use it in buying what he wants. Iron would not be a good money-material, because it would be impossible to carry around any considerable value of it.

(3) **Uniformity.**—A good money-material must be the same throughout; that is, each unit quantity of it must be equal in value to any other unit quantity. For this reason, cattle and grain, which vary widely in quality, are not good money-materials.

(4) **Durability.**—It should not be easily destructible—to the loss of its owner.

(5) **Cognizability**: that is, it should easily be known at sight. It is very important that whatever is chosen as money should be very difficult to imitate.

(6) **Divisibility.**—It should be divisible without loss of value. This shuts out the precious stones, which from some points of view would make an almost ideal money. Precious stones cannot be divided without great loss of value. Large stones have, as compared with smaller ones, a value out of all proportion to their size. Five diamonds weighing one carat each are not worth nearly as much as a single diamond weighing five carats.

Gold and Silver Make the Best Money-Materials.

Gold and silver possess all these qualities: general acceptability, originally arising out of their use as ornaments; portability, because of their great value contained in small bulk; uniformity, because they are chemical elements; durability—gold coins of the Roman Empire are constantly being picked up in Europe, and may be seen uninjured in our museums to-day; difficulty of counterfeiting, largely because of their great weight in small bulk; divisibility, because a gold or silver coin, when it is **standard money,*** has value directly proportionate to the amount of gold or silver contained in it.

Money a "Universal" Commodity.

Money is thus what is called a universal commodity, for which you can, under ordinary conditions of civilized life, secure any commodity you desire. If you have any other commodity in your possession, you may find it hard to secure money for it; but if you have money in your possession, you can easily get anything else. Buying is, therefore, in itself easier than selling. The purchaser has an advantage over the seller of goods, because he has something which is universally desired by all people; whereas the seller may have in his possession something which no one desires, and which, consequently, he cannot turn into money. When a man goes down town with spending money in his pocket, he is practically the master of the commodities of the whole world up to the purchasing power of the money which he possesses.

Money the Only Legal Tender.

Furthermore, arising from this universality, money is the only commodity with which a man can legally pay his debts. Otherwise he might be able to force on his creditor something of no use to the latter. If he lacks money, he may in vain offer his creditor on settling day commodities worth, under ordinary conditions, double or treble what he owes him. He is none the less a bankrupt for that.

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*The phrase "standard money" is explained further on in this lesson.

Money is the only legal tender—the only commodity which a creditor must accept in payment of a debt.

In every panic or commercial crisis, such as occurred in the United States in 1907, men who have had millions of dollars worth of property have seen themselves bankrupted and ruined for the lack of ready cash to meet their pressing obligations. Consequently at such times men are ready to pay exceedingly high rates of interest for the use of money, since this is the only way in which they can weather the storm. In these days such crises are usually of short duration, since gold and silver easily pass from one country to another, attracted by the high rates of interest obtainable in the country which is suffering from panic at the time.

Money Originally Weighed Out.

Originally money—gold and silver—was measured out by weight in payment for a commodity, as is illustrated by the fact that the English word "pound" meant originally a pound weight of silver. This was, however, found to be a clumsy procedure, and not very effective, as one could not tell from the weight measured out just how much alloy of baser metals it contained, and therefore could not be sure how much gold or silver was being received.

When trade grew more important and came to be an object of Government protection, we have the Government undertaking to strike pieces of gold and silver (called coins) having a certain fixed weight and a certain degree of fineness. This was done in order to help trade, because it was quite clear that holders of goods were going to be very chary of selling them unless they knew just what they were going to get in return—just how much purchasing power.

Standard Moneys.

Various governments, then, have adopted various standards of gold and silver as standard money. Thus the Canadian and American standard is the gold dollar of 25.8 grains, nine-tenths fine, i.e., containing 23.22 grains of pure gold. The English standard is the gold pound piece or sovereign, weighing 123.27 grains, eleven-twelfths fine, thus containing 112.99 grains of pure gold. If the student will divide the weight of pure gold in a sovereign by that of a gold dollar, he will find how many dollars go to the pound.

Characteristics of Standard Money.

The gold dollar is, then, our standard money, just as the pound is England's standard. The value of everything we buy and sell is reckoned in dollars, that is, it is equal to so many times 23.22 grains of pure gold, whether coined or uncoined. It is a general principle with civilized nations that their **standard coin shall have an intrinsic value equal to the value stamped upon it.** Melt down a new five dollar gold piece, and the gold you have is still worth five dollars.* From long experience it has been found that for the government to force on its people standard money which is worth less as metal than it is when coined, is a great mistake, and inevitably leads to financial troubles and inflation of the currency. If a government, for instance, were to coin a dollar, with, say, only half the gold in it that it now has, it could not in the long run make people give as much goods for it as they do now for the heavier dollar. The merchant would just double his prices, charging $2.00 where he now charges $1.00, and thus he would get just as much gold for his wares as he got before.

The greatest objection to such action on the part of the government is, however, that it would cheat all those who happened to be creditors at the time. It would entirely upset the correctness of our standard of deferred payments. A creditor would have lent his debtor dollars containing 23.22 grains of gold, but would have to receive in return dollars with only half the amount—11.61 grains of pure gold in them. The debtor would be repaying him in "lawful money of Canada," which would be all that he could ask. And when he went to spend these dollars, he would, as we have seen, get in exchange goods which he might have obtained before for only fifty cents. Creditors would, therefore, lend their money in some other country, where the standards of coinage were more stable, and would avoid making any investments in Canada. Since we are so urgently in need of the capital of foreign investors to develop our country, this would be almost ruinous to Canada. Such would be the result of trying to disobey the old rule that standard money—the money which creditors are bound to accept from their debtors and sellers from buyers—must have intrinsic metallic value equal to the value stamped upon it.

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*The government makes a profit—called seigniorage—on the coining of our silver money, since the 50 cent piece for instance, contains only about 21 cents' worth of silver. The government buys 21 cents' worth of silver, makes it into a coin, and calls it 50 cents. Clearly there is a considerable profit on the transaction—a profit which does not accrue in the coinage of standard money.

If, however, you melt down Canadian silver coins, you will find that you have lost in the process. The silver contained in the quarter dollar or the half dollar is worth less than half the value stamped upon it. Our copper coins are worth a still smaller fraction of their stamped value. How is it, then, that these coins are given and received everywhere at their stamped value, when the value of the silver in the fifty-cent piece, for example, is not nearly equal to that of 11.61 grains of pure gold?

Token Money.

The answer is simple. These coins are what is called **token money.** They continue to circulate only because the government will give you a five dollar gold piece for 10 silver half dollars, or 20 silver quarter dollars, and so on. These coins only **represent** gold. They are just like little cheques payable to bearer. While there is not fifty cents worth of silver in the half dollar, the government will give you fifty cents' worth of gold in exchange for the silver half dollar coin. Why, then, use the silver at all? Simply because gold coins of very small denominations—the gold dollar, half dollar and quarter dollar—are too small and thin and wear away too easily to be convenient as money. The loss from abrasion is, in the aggregate, considerable, even in the case of the half-sovereign, the sovereign, and the five dollar gold piece, and would naturally be much greater among the smaller pieces, which have so much larger surface in proportion to their weight.

The merely subsidiary nature of our silver and copper coinage is sufficiently indicated by the fact that no creditor need receive from his debtor at one time more than 25 cents in coppers or $10.00 in silver. These lesser metals are, therefore, legal tender only in very small amounts.

Dominion Notes Represent Gold.

But, the student may say: "In the course of our daily lives we see little or no gold coin. How can that which we so rarely see be the standard legal tender money of our country?" Simply because the Dominion legal tender notes, whether notes of small denominations in circulation throughout the country, or notes of large denominations held as reserves by the banks, are all token money, just like the silver and the copper coins, and they pass current just because they state that the Dominion of Canada will pay to the bearer one or more dollars—presumably gold dollars, and the Dominion is able to do it. The Dominion holds in its treasury gold far more than sufficient to pay off at any time all of these bills that are likely to be presented. The Act which regulates the issue of Dominion notes is known as III Ed. VII, chapter 43. As its provisions are not any too well known, we will give them verbatim:

"Notes of the Dominion of Canada may be issued and outstanding at any time to any amount, and shall be a legal tender in every part of Canada except at the offices at which they are redeemable.

"The Minister of Finance and the Receiver-General shall always hold as security for the redemption of Dominion notes issued and outstanding at any one time, up to and including $30,000,000, an amount in gold, or in gold and securities of Canada, the principal or interest of such securities being guaranteed by the Government of the United Kingdom, equal to not less than 25% of the amount of such notes so issued and outstanding, provided that the amount in gold shall be not less than 15% of the amount of such notes so issued and outstanding, and as security for the redemption of Dominion notes issued in excess of $30,000,000, an amount in gold equal to such excess."

Thus, when there are $100,000,000 of Dominion notes in circulation, the Government must hold in the treasury $4,500,000 in gold and $3,000,000 more in gold or guaranteed securities against the first $30,000,000 and $70,000,000 in gold against the remainder. When there are $100,000,000 of notes in circulation, there is thus at least $74,500,000 in gold in the treasury to redeem them.

Our whole monetary system rests, therefore, on a gold basis—the gold in the Dominion Treasury at Ottawa. Canada is, thus, what is called a monometallic country—a country where there is only one standard money-metal—gold.

In any typical gold monometallic country the Government maintains the commodity value and the coin value of its standard money-material—gold—on an equality by freely coining gold bullion into standard coin—sovereigns or dollars or whatever the case may be—for anyone who brings it to the mint. Or, which amounts to the same thing, the Government may at once give an equal weight of standard coin to anyone who brings in bullion or an equal weight of bullion to anyone who brings in standard coin. Thus **there cannot be any appreciable divergence between the intrinsic value of the gold and the value stamped upon it by the Government.**[*] Anybody who has the one can always get an equal amount of the other.

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[*] In the United States, as also in England, there is a slight divergence, since the man who brings in bullion to the mint has usually to wait several weeks before he can get his coin. Thus he loses the interest of his money for that period. In England practically everyone who wants gold coin in exchange for bullion pays the Bank of England's commission of 1½d (three cents) on the ounce of standard gold (worth £3, 17s, 10½d, or about nineteen dollars), and gets his gold coin at once. The Australian branches of the British mint also charge 1½d for coining an ounce of standard gold into sovereigns. This charge, which does not cover the expense of coining, is known as **seigniorage** or brassage.

Monometallism and Bimetallism.

Some countries have in the past had two standard money-metals—both gold and silver. Practically all have now given up the cause of silver as an unlimited standard money-material. The great controversy which raged for so long between the two principles has been decided in favor of gold monometallism as the best basis for a circulating medium. A brief survey of the field will show the causes of the victory of gold over silver and will teach us much about money.

The first essential of a bimetallic country—a country which freely coins both gold and silver for anyone who brings them in to the mint—is a fixed ratio of value between the two metals. Thus for a long time the United States coined silver and gold at the fixed ratio of 16 to 1—that is, 16 ounces weight of silver in coins were always to exchange for 1 ounce weight of gold in coins. The silver dollar contained 371.25 grains of pure silver; the gold dollar 23.22 grains of pure gold—one-sixteenth of the weight of silver in the silver dollar. The one was, the United States Government said, always as good as the other. They were always ready to give either one in exchange for the other.

The great difficulty about this procedure is that the value of silver and the value of gold both depend upon the supply of and the demand for these metals. A great increase in the supply of silver mined, naturally sends down the value of silver as expressed in gold; a great increase in the amount of gold taken out of the mines, when combined with a decline in the production of silver, means that as much silver as before cannot be obtained in return for a fixed quantity of gold. No government is strong enough to establish a fixed relation between the values of gold and silver.

What would have happened if the proposition of the Democratic party in 1896—to restore the free coinage of silver and gold in the ratio of 16 to 1, for anyone presenting them at the mint—had been carried into effect? The result would have been somewhat as follows:

The owners of silver mines, within or without the United States, would have sent their silver to be made into silver dollars at the United States mint. As soon as they got their silver dollars back, they would have exchanged these for gold dollars, so that for every 16 ounces that they had had of silver coins, they would then have 1 ounce weight of gold dollars. They they would have exported that 1 ounce weight of gold coins from the United States to some country, where, under the natural working of the laws of supply and demand, they would be able to get 30 or more ounces of silver or silver coin in exchange for the 1 ounce of gold. Thus they would have 30 ounces of silver where they had had only 16 to begin with—in other words they would have nearly doubled their money.

Silver from other countries would have tended to go to the United States, where it was over-valued as compared with the world-wide market value. On the other hand, gold, undervalued in the United States, would pass from that country to others. In time the United States would have lost practically all their gold, because everyone would want to send it where he could get 30 ounces of silver for 1 ounce of gold instead of only 16 ounces. Everyone with silver would want to send it into the United States, because there he could get 1 ounce of gold for 16 ounces of silver, while elsewhere he would have to pay 30 ounces of silver for 1 ounce of gold.*

This is rather an extreme case, but the fact remains true everywhere. Where two metals are both in circulation as standard money in a country, one of them will necessarily be undervalued or overvalued in terms of the other, because the fixed ratio necessarily adopted by a Government for purposes of coinage does not vary with the changes in the real values of the metals as decided by the operation of supply and demand.

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*In 1911, according to the Director of the United States mint, it required 38.33 ounces of silver to equal in value 1 ounce of gold. At this rate, the American silver dollar contains only 41.7 cents' worth of silver.

Gresham's Law.

The overvalued metal—the metal that is not really worth what the mint says it is—will then stay in the country or even pour into the country from outside; the undervalued metal—the metal that is worth more of the other metal than the mint will give for it—will leave the country. In other words, where two metals circulate as standard money, bad money—money not intrinsically worth the value stamped on it—drives out good money—that which is worth the face value stamped upon it. This principle is known as Gresham's Law.

One does not, however, have to go to a bimetallic country to see the operation of Gresham's law. This can be seen among ourselves. It is common experience that a five dollar gold piece gradually loses a slight fraction of its weight through abrasion—so that a gold piece ten years in circulation is appreciably lighter than one which is fresh from the mint. Now wholesale jewellers get a large part of the gold used in their business by melting down sovereigns or other gold coins. Evidently they will have more gold if they melt down the new coin just issued from the mint. Here again the old light coin is allowed to remain in circulation, because owing to abrasion it is no longer worth quite the value stamped upon it, while the new heavier coin, the gold in which is worth the face value, is melted down. "Bad money drives out good."

Here is another case where Gresham's law might come into operation among us. Suppose the Dominion Government were in financial difficulties and were unable to give you gold in return for Dominion notes. What would happen? Why, this—whenever a piece of gold was paid to you, you would hold on to it, hoard it up for a rainy day, because it would still be good money, you could still get what you wanted for it, whether the Dominion Government became bankrupt or not. In other words, you would withdraw the good money from circulation while you would pass on to other people the Dominion notes received by you—i.e., you would keep the bad money in circulation. "Bad money drives out good."

A fuller statement of the law is given in Palgrave's Dictionary of Political Economy: "Where by legal enactment a government assigns the same nominal value to two or more forms of circulating media whose intrinsic values differ, payments will always, as far as possible, be made in that medium of which the cost of production is least, and the more valuable medium will tend to disappear from circulation."

Thus, then, we seem to have come to the conclusion that because of the truth expressed in Gresham's law, it is impossible for one nation to maintain a bimetallic system, because it would be inevitable that one or other metal would be undervalued, and the undervalued metal would leave that country with disastrous results to its whole financial system, while the overvalued metal would become the daily medium of exchange, so that the bimetallic country would be monometallic after all. Had the Democratic programme of 1896 been carried into effect, the United States would now be in difficulties for the lack of gold to repay the money which it owes Europe and which it cannot pay in silver. With its money system in disorder, it would be practically impossible for that country to secure loans from other nations.

Paper Money.

Paper money is extensively used by civilized nations instead of metallic money, over which it has certain advantages, provided that it has good security for its redemption. It is more convenient, as it is so easily carried about and transferred from place to place. It also saves to the country the loss due to abrasion of the coinage. There are three kinds of paper money: representative, fiduciary and inconvertible.

Representative money is that in which every note, like the United States gold and silver certificates, represents an equal sum of money deposited somewhere (as in the U. S. Treasury) for the redemption of that paper with silver or gold. If all these notes were brought into the treasury at the same moment, they could all be paid.

Fiduciary paper money is that which, like our own Dominion notes, is redeemable at the Dominion Treasury. But in this case the Treasury has not the wherewithal to pay off at one time all its notes in circulation, so that this is called fiduciary (fiducia, confidence or credit), because its acceptance in the ordinary course of business depends on the general credit of the country.

Inconvertible Paper Usually a War Measure.

Inconvertible paper money is that which does not give the holder any legal claim to receive metallic money in exchange for it—it cannot be converted into gold or silver at his wish. It is often issued by Governments at critical times when they have no coin with which to meet their obligations. The Americans issued it to finance the Revolution, the Confederate States to finance the Civil War. At such times it might be considered a patriotic duty not to embarrass the Government, and the takers of such money would hope that when the crisis was over these obligations would be redeemed with something more tangible. This money, indeed, passed from hand to hand, becoming less valuable (in relation to gold) as it increased in quantity, and the chances of redemption thus became more remote. Though there are certain theoretical arguments in its favor, the issue of inconvertible paper money has never turned out satisfactorily, either for the issuing government or for the people who had to accept the money.

The Value of Gold.

We have seen that standard metallic money must have intrinsic value equal to the value stamped upon it by the Government. Gold gains nothing in value by being coined. In other words, its value as a commodity is equal to its value as money. We usually prefer having it in the form of money, because then its value is indisputable, guaranteed by the Government, and we can get what we want in exchange for it.

How are we to measure the value of the commodity, gold? Simply by the amount of other commodities which we can get for it—its power in exchange. Now the value of the commodity gold depends upon the supply of and the demand for gold, just as is the case with any other commodity. If the demand for gold increases faster than the supply, the value in exchange of gold will increase; a given amount of gold will purchase more than before. If the supply of gold increases faster than the demand for gold, the value in exchange of gold will decline, i.e., a given amount of gold will purchase less than before.

The Rise in Prices.

This is exactly what has happened during the past ten or fifteen years. The years since the Boer war have seen a production of gold unprecedented in the history of the world.* The supply of gold has, consequently, grown faster than the demand for it, and as a result a certain fixed quantity of gold (the English sovereign or the American gold dollar) purchases less of other commodities than before. This is one and probably, as the Massachusetts Commission on the Cost of Living has stated, the main cause of the rise of prices, which, according to the statistics of the Canadian Department of Labor, have increased about one-third over the average prices of the decade 1890-1899. This is equivalent to saying that it now takes 4 gold dollars (4 times 23.22 grains of pure gold) to purchase what might then have been purchased with 3 gold dollars. In other words, the gold dollar now purchases only what seventy-five cents purchased then. Its purchasing power has thus seriously declined, and salaries have in most cases had to be increased as a result.

Effects of the Decline in the Value of Gold.

This decline in the purchasing power of gold has, on the whole, operated adversely to creditors and favorably to debtors, adversely to mortgagees, and favorably to mortgagors. If a man mortgaged his house in 1907 for a term of five years, the gold dollars which the mortgagee received in 1912 have less purchasing power than those which he gave the mortgagor five years before. From the point of view of pure justice, this is no doubt to be lamented, but there does not appear to be any remedy in sight. Various economists have proposed some more stable standards of deferred payments than gold has of late shown itself to be, but these are theoretical rather than practical, and gold as a standard money apparently reigns supreme in the hearts of the great majority of civilized mankind. There is no prospect of its being displaced by any merely theoretical standard money.

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*According to the reports of the United States mint, the world's production of gold increased from roughly $200,000,000 in 1895 to $375,000,000 in 1905. It reached, in 1910, according to the United States mint, the unprecedented figure of $454,000,000.

What Does "Money" Include?

Now at the end of our lesson, we come to the very thorny question: "Just what is to be included under the term money?" Here economists and financial writers widely disagree.

The most restricted definition of money is perhaps that given by Conant in his work on "The Principles of Money and Banking," vol. 1, p. 4. He says that money is "that commodity of intrinsic value acceptable in exchanges, which has become by law or custom the usual tender for debt." This would appear to exclude even silver token money such as ours.

A wider definition is "money is all that is authorized by law to be used in the payment of debts—all legal tender." This would include Dominion notes.

A third and still wider definition is "money is that money does." All is money that serves as a medium of exchange. This with us would include not only bank notes but bank deposits. "Bank deposits," says Taussig, "as well as bank notes constitute part of the actual circulating medium." One pays his debts by checking upon his deposit just as satisfactorily as by paying them in legal tender notes or gold.

Any of these definitions may be defended or attacked.

There is the very best authority for every one of them. Those who hold to the narrower definitions point out that behind every cheque, every bank note, there must be somewhere or other gold dollars which the man who accepted that cheque or that note could get if he really wanted them. Therefore, they say cheques and notes are not money, but merely substitutes for money. On the other hand, there is the equally indisputable fact that bank notes and cheques (or deposits) are actually a very important and widely current medium of exchange, or money.

In such a case the student must take his choice of these definitions and be ready to defend it by reasonable arguments. The next lesson—that on credit exchange or banking—will further aid him in so doing.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON 8.

1. What difficulties of a system of barter are overcome by the use of money?
2. What are the functions of money? Discuss.
3. What are the chief qualities of a good money-material? What commodities possess these qualities in the highest degree? Discuss.
4. Why cannot wheat be used as money?
5. What is standard money? What is token money, and why do we need it?
6. What purposes are served by the use of Dominion legal tender notes? Under what restrictions are they issued?
7. Why does the Act say that Dominion notes shall be legal tender everywhere "**except at the offices at which they are redeemable**"?
8. What is bimetallism? What would the probable result have been if it had been adopted by the United States in 1896?
9. What is seigniorage? Why does the State undertake the business of coining money?
10. Explain fully the working of Gresham's Law in the different cases where it comes into operation.
11. What are the three kinds of paper money? Give examples of each, and discuss.
12. Discuss the increased production of gold as a cause of high prices. Would you suggest any other possible causes?

ECONOMICS

LESSON 9

By

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ECONOMICS

LESSON IX.

Credit in Exchange: Banking.

THE fundamental idea in credit is trust, *confidence*—the confidence of one person in another, which makes that first person ready to sell goods to the other without receiving money for them at the time of the sale. The seller becomes the creditor of the buyer and remains so until the buyer has paid in money for the goods, or until he has otherwise discharged the debt. There is no theoretical reason why the buyer should not pay in some commodity agreed upon at the time when payment is due, but as a matter of fact he practically always agrees to pay in money.

Credit involves the idea of deferred payments—the exchange of a present commodity—the goods in the possession of the seller—against a future commodity—the money which is to be paid by the purchaser. It is well defined by Joseph French Johnson: "Credit is an executory contract to deliver money, and is accepted as a means of payment because the acceptor is confident that the maker will be able and willing to deliver the money if called upon to do so."

In business, a creditor does not usually extend credit unless he is satisfied of a debtor's ability to pay, or unless he has some security other than the latter's mere word. A bank when making a loan usually insists that the loan shall be used for what we call reproductive purposes. As the celebrated French economist, Leroy Beaulieu, says: "Credit should not be a simple anticipation upon future and uncertain wealth; it should have for its basis a thing real and actual—goods which are finished and which have not been sold; goods which, having been sold, have not yet been paid for; goods even, which are in process of manufacture, and of which all the elements have been gotten together; an enterprise which is not terminated, but which is already in a certain degree of advancement."

Credit Involves Higher Prices.

It must not be forgotten that credit prices are inevitably higher than cash prices. When the seller of an article agrees to wait for payment he puts himself to a certain amount of inconvenience and loss. The present possession of a given amount of commodities is always worth more than the right to receive an equal amount in the future. Besides this, there is always some uncertainty about anything which is to occur in the future—uncertainty as to whether the debtor will be able to pay, uncertainty as to whether the creditor will be alive to receive payment, and this uncertainty, as well as the inconvenience of waiting for payment and the risk of non-payment, must be paid for.

Importance of Credit in Modern Business.

While credit inevitably involves higher prices, its importance in our modern world is stupendous. It enables the individual to transact an extraordinary amount of business with a very small capital, and the community to get along with an amount of currency exceedingly small as compared with the amount of business transacted. The retailer often grants credit to the general public; the wholesale merchant grants credit to the retailer, enabling him to sell his goods to the public before having to pay for them; the manufacturer gives credit to the wholesaler, the bank to the manufacturer, the general public to the bank. So, then, we have a perfect circle of credit, including all those concerned in the production, the handling, and the consumption of the goods. Everyone believes that the person to whom he has granted credit will be able at the time agreed upon to meet the obligation with ready money. Usually this trust is justified; otherwise it would not exist.

The Failure of Credit.

Sometimes, however, for one reason or another—perhaps a failure in the crops which makes the farmer unable to meet his obligations to the retail merchant, who has trusted him for supplies, or to the manufacturer, who has sold him agricultural implements on credit—the debtor is unable to meet the payments agreed upon, and his creditors are consequently unable to discharge their obligations, and their creditors likewise, and so on. The shock of the crop failure is thus transmitted throughout the whole business world, just as the shock of a stone falling into water from a height is transmitted in widening circles throughout the whole expanse. As a result everybody, except perhaps the banks, ceases to give credit, and demands ready money for whatever he sells. Confidence, and with it credit, has departed, and as a consequence the business of the country contracts, bringing hardship to many and bankruptcy to some. Such a condition is known as a business depression or a "crisis." Its most disastrous effects may be avoided or at leat minimized by the granting of credit by our banks to all those entitled thereto, *i.e.,* to people who are really solvent but who are unable to realize on their property at the moment, and may thus be forced into bankruptcy. This is one of the greatest services the banker renders to the community.*

The Bank and Its Functions.

"A bank may be described in general terms," says Dunbar, "as an establishment which makes to individuals such advances of money or other means of payment as may be required and safely made, and to which individuals entrust money or the means of payment when not required by them for use." That is, its business is to make loans and to receive deposits. These are the essential functions, but in almost all countries some or all of the banks have the additional function of issuing notes—promises to pay which circulate practically on a par with money and are considered just as good as money. Sometimes these notes are legal tender, as in the case of the Bank of England's notes. Sometimes, as with us, they are not. When the process of note issue is analyzed it will be found that it really is only a particular variety of deposit, in which the depositor of values with the bank receives promissory notes instead of book credit.

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* Of course, a bank cannot in its own interest afford to jeopardize its financial position by unduly reducing its reserves in a "crisis" in order to help even its best and most solvent customers.

Definition of the Bank Note.

''A bank-bill or note is a non-interest-bearing obligation payable to bearer upon demand, in lawful money, title to which passes by delivery. The value of such note depends upon the financial credit of the bank issuing the same, the special provision of law for its redemption, the security set apart for such purpose, the fidelity with which such laws are enforced as to redemption, the character of supervision, and the degree of conservative banking thereby insured.''—Comptroller Hepburn, Annual Report to Congress, 1892 (page 14).

Importance of the Bank-Note to New Banks.

The function of note issue, though not essential to a bank, is nevertheless very important historically, and thus deserves our careful consideration. In the early history of the banking systems of different countries, as well as in the early history of most individual banks, there was a time when either the banking system or the individual bank was too new, too untried, to secure the public confidence.* Many people still feel that since the interest paid by Canadian banks on savings deposits is almost universally three per cent., the savings depositor may as well put his money into the safest possible institution. This need not necessarily be one of the largest banks, but usually the depositor will think it is.

Here is where the importance of the function of note-issue comes in. If the State, under what the Americans call its ''police power,'' permits the new bank to issue, with all possible safeguards, promissory notes without interest, payable to bearer, the public will generally be ready to accept these notes, whose goodness is fairly well established under the Government's regulations. Various people who trade with the new bank accept these promissory notes in place of legal tender because they feel that their creditors will accept this bank-note currency likewise. Thus we have the promissory note starting out over the country. It may conceivably remain unredeemed for a year, in which time a ten-dollar note would earn an appreciable sum for the issuing bank.

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* In new communities, too, there is very little surplus saved up, as money or capital which is not in active use. Thus deposits in such a community are small, and do not remain in the bank for long periods, as in older districts.

Profit From Note Issue.

For every ten-dollar bank-note in circulation someone has given the bank values to the extent of ten dollars (or his promise to give those values plus interest at some date in the near future), and instead of legal tender has accepted in payment the non-interest-bearing promissory note. Possibly the same man brings in the note at the end of a year and receives only the legal tender which he might just as well have received at the beginning. In other words, the bank has had the use of the ten dollars for a year for nothing; it has gained the interest accrued thereon. Of course, he has much more probably passed on his note to another man, and he to another, and so on, so that the loss of each holder is exceedingly small.

The function of note-issue enables the bank to advertise itself as an institution with a strong credit. Thus it gradually grows in favor with the public, and by degrees people begin to drop in and deposit their savings with it; others come in to borrow money or to get credit.* In most cases where loans are made the amount of the loan is entered to the credit of the borrower as a deposit. Thus the liabilities of the bank—its deposits—and the assets—the money due it—are increased by the same transaction.

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* In Prof. Seligman's collection of addresses on the Currency Problem, Mr. Frank A. Vanderlip, Vice-President of the National City Bank of New York, says: "The business of the modern bank is almost wholly the exchange of credit—to use a clear but homely phrase, the swapping of credits. . . . . Almost its entire business consists of receiving from customers their evidences of indebtedness, which have a narrow currency, and giving to those customers in exchange the bank's evidences of indebtedness, which have a wide currency." So, too, Mr. McLeod, in his evidence before the National Monetary Commission, stated that approximately 90% of the banks' total business in Canada is done by cheques.

To young banks and banks in newly-settled districts the right of loaning to the public through note issue is of very great importance. Under our Act the notes of the new bank are just as good from the note-holder's point of view as those of the oldest and best established of banks. The note will remain in circulation wherever people are accustomed to accept such notes and to have them redeemed without question.*

Bank notes in circulation, though not money, are in fact a substitute for money. Now the coining of money is a Government prerogative—a Government monopoly—and probably by analogy, the Governments of most countries exercise a strict control over the amount of bank notes which a bank is allowed to issue, since these compete with money. Both Governments and banks are concerned to keep bank notes for all practical purposes on a par with money, the Government because it does not wish citizens to be victimized by banks of the meaner kind (as happened in the United States before 1850), the banks because they cannot circulate a single note unless citizens are ready to accept the notes freely. So when a bank note comes into your possession you may be sure that someone—the man who voluntarily accepted it from the bank in payment of a debt—trusted the bank with that value long before you received it. Also, the very fact that you have that note in your pocket indicates that you are in no hurry to have it cashed. Apparently you, as well as the man who first accepted the note from the bank, have confidence in the bank. You consider its promise to pay as being just as good as actual money, especially as you can readily get your creditor to accept, though he is not legally bound to do so.

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* In 1825 the Bank of Montreal had notes in circulation to the amount of £137,580, and deposits of only £105,518. In September, 1912, it had notes in circulation to the amount of $15,628,802, deposits of $183,423,686. Thus the deposits, which were considerably less than the notes in circulation in 1825, were nearly twelve times as great as the notes in circulation in 1912.

Safeguards of the Bank Note.

In Canada, as in most other countries, the man who holds a note of a bank has a special reason for giving it his confidence: he is in almost all countries a preferred creditor —a creditor whose claim ranks in advance of all others. In our own country no note-holder has lost a dollar since Confederation except in the case of the failure of the Mechanics Bank of Montreal, where the note holders were not treated as preferred creditors,* and the notes of our youngest and weakest bank pass current as easily as those of our oldest and strongest. We do not suppose there is a business man in the country who would refuse a note of a chartered bank—unless, indeed, it were one of a bank in process of liquidation. If he refused even this it would only be a proof of his ignorance, for the notes of an insolvent bank must either be redeemed by the liquidator within two months (with interest at 5% from the date of suspension to that of payment), or they will be redeemed with interest by the Minister of Finance out of the Bank Circulation Redemption Fund (a fund held by the Minister amounting to 5% of average note circulation, to which all banks must contribute, and out of which all notes of insolvent banks must be paid, even if the assets of the insolvent bank are insufficient to reimburse the Fund for the expenditure). The note of an insolvent bank, therefore, after the bank becomes insolvent, is really worth a little more than the perfectly good note of any other bank. Banks, therefore, willingly accept such notes from the public, knowing that there is a slight profit and no risk in handling them.

Another safeguard of the note-holder is to be found in the provision that all chartered banks must be prepared to redeem their notes at the leading business centre of each province.

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* For details of this feature, see Breckenridge, The Canadian Banking System, 1817-1890, pp. 217-218. The Mechanics' Bank was operating on a pre-Confederation charter.

Nor is this the only precaution. It is also provided by law that no bank shall issue notes to an amount greater than that of its paid-up capital, except in the months from September to February inclusive, when they may issue an extra amount equal to 15% of the combined amount of their paid-up capital and reserve. The banks must pay the Government 5% interest on this emergency note-issue. Thus note-holding creditors of an insolvent bank, could during half the year at least, be entirely paid off from the proceeds of the double-liability unless some of the shareholders defaulted.* The reason for permitting the emergency issue is simply that the extra notes are needed in the West to pay for the harvesting and sale of the crops.

So, too, in England note-holders are specially protected. There, the Bank of England, if we except a few survivals of old note issues from before the Bank Act of 1844, is the only issuer of notes. To secure all note-holders payment of their notes, it is provided that all notes must be covered either by gold or by the bank's holdings of Government securities or other securities approved by the Government. According to law, the first £18,450,000 worth of notes may be issued against the above-mentioned securities. For all notes issued above this, the issue department of the bank, which is entirely separate from the Banking Department, holds gold, either in coin or bullion. The bank has thus the gold ready to redeem all the notes that are ever likely to be presented for payment. It is well that the Government should make these stringent regulations, since Bank of England notes are practically the only paper currency used in England. Bank of England notes in England, like

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* Consolidated Canadian Bank Act. Revised Statutes of Canada, 1906, chap. 29, section 125:—In the event of the property and assets of the bank being insufficient to pay its debts and liabilities, each shareholder of the bank shall be liable for the deficiency, to an amount equal to the par value of the shares held by him, in addition to any amount not paid up on such shares.

Dominion notes with us, are full legal tender, except at the appointed places of redemption.

In the United States the bank notes issued by the National Banks must be issued only against United States bonds owned by the banks, but held by the Secretary of the Treasury. If a bank becomes insolvent its notes are redeemed by the Secretary of the Treasury and its bonds sold to reimburse the Government. Thus the notes of the United States National Banks are really issued against the Government's credit, and are safe to be redeemed as long as the Government itself is solvent. The citizen of Maine who receives a note of some little national bank in California does not have to speculate on the probable financial standing of that particular bank. His note rests on the general credit of the United States, just as our Dominion notes rest, to some extent, upon the general credit of Canada.

Freedom of Note Issue.

Lately there have been suggestions in Canada that all these special advantages given to note-holders should be abolished and that banks should be permitted to issue notes freely, and untaxed, to any extent required by the needs of business. The fact that under such circumstances notes would come into the clearing-house for redemption would, it is claimed, prevent an over-issue of notes at any time. What difference does it make whether a bank's credit is extended in the form of notes or by an entry in its books?

No doubt this argument is, from the business point of view, quite correct. Still the common-sense of nations seems to agree that the note-holder is deserving of special treatment. He is practically an involuntary creditor, while the depositor is a voluntary creditor, who might have put his money in the Post Office Saving Bank instead of the other, if he had wished to do so.

From the strictly economic point of view or the point of view of the banker, it may be desirable that our banks should be consolidated and no new ones established. Certainly the banks that have failed within the past generation have for the most part been young and short-lived. Yet the borrowing public generally would sympathize with the new bank, believing, as it does, that consolidation has already gone quite far enough. In this belief it is apparently arguing from its experience of loans. Possibly the saving public might have another story to tell. It is to their advantage to have their savings kept as safely as possible, while still obtaining a fair rate of interest for them. Some of them, as J. F. Johnson says, regard the established rule of 3% as too small a rate on savings deposits in such a young and developing country as this, but probably the majority value the use of cheques on savings deposits as a privilege which offsets the low rate of interst.

Advantages of Note Issue to the Public.

Why should banks have the right to issue notes at all? What advantage is there to the public in their doing so? The great advantage lies in the elasticity which these bank-notes give to our currency system. This may well be illustrated by the chart in J. F. Johnson's Canadian Banking System, p. 66. If you look at that chart you will find that in nearly all years the highest point of circulation is on October 31, the time when the moving of the crop is being financed. This elasticity enables our banks to aid greatly in bringing out the crops of the North-west. The United States, with its bank note circulation based on United States bonds, does not enjoy this elasticity.

The required elasticity in the supply of currency cannot well be secured through the use of Dominion notes, since the Government is not in touch with business conditions throughout the country as the banks are. It does not possess the machinery necessary for putting these notes into circulation at hundreds of places throughout the country. Thus the circulation of Dominion notes does not vary and cannot well be made to vary with the seasonal needs of business throughout the year.

Loans and Deposits.

Many banks, such as the American State banks,* do a thriving business without the function of note issue at all. They live by receiving deposits and making loans, and the former is often a consequence of the latter, so that we may consider lending, from the banker's point of view, as the main function of a bank. The first thing that a new bank of this kind does is to lend a portion of its capital to its customers, or to lend them its credit in return for theirs. Here is the process, as illustrated in a small American State bank.

A banker begins with $10,000 capital; this capital, combined with his own reputation, brings him in $50,000 of deposits. He finds that his depositors deposit approximately as much as they withdraw, so he is reasonably sure of having $60,000 cash on hand all the time. With this money he begins to discount commercial paper, and for a $1,000 note which has three months to run he sets down to the credit of the seller of the note $985. He finds that as a rule this money is not immediately called for, and that he can safely discount about $200,000 of commercial paper in the same way and on the same terms. Then his balance sheet will be:

RESOURCES.		LIABILITIES.	
Cash	$ 60,000	Deposits	$247,000
Loans & Discounts	200,000	Capital	10,000
		Profit	3,000
	$260,000		$260,000

How Credit Is Created.

Now $50,000 of the banker's deposits is in actual cash, but the other $197,000 represents nothing but his credit, which he is loaning to his depositors—it is created by his good reputation and by his resources. His depositors, we will suppose, never want to turn their deposits into cash faster than the notes which he discounts come to maturity and are converted into cash. So his debtors have in their business the use of $200,000 of the banker's credit, and pay him interest for the use of it, just as if it were actual money.

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* These are so called because they operate under charters from the State, instead of from the National Government.

Suppose, however, rumors begin to get afloat that Mr. So-and-So's bank is not very secure. Depositors begin to come in for their money or to draw cheques to more than the ordinary amount. Then the small banker, if the commercial paper which he has bought is good, can re-discount it with some larger bank, and thus secure the cash to meet his obligations.* If he is unable to do this, he necessarily suspends payment, and is often forced into bankruptcy. The result is the loss of his capital and probably of some portion of the money due to his depositors.

Commercial and Savings Banks.

In most countries there exist two kinds of banks—commercial banks and savings banks. The chief difference between them is simply that commercial banks deal mainly with commercial people who are continually depositing or withdrawing large amounts. Accordingly, the commercial bank must keep as a reserve a large percentage of its liabilities, since it must be ready to pay off, at a moment's notice, any of its obligations. All its assets must be "liquid," easily realizable, and as a rule it does not make any investments which will tie up its assets for more than three months at a time, *e.g.,* sixty-day or ninety-day commercial paper. In case of a sudden stress, it should, unless the crisis is general, be able to re-discount this paper with another bank.

In savings banks, on the other hand, the deposits are usually repayable only after notice, and the amount of deposits likely to be paid out in a certain period is much less than in the case of a commercial bank. Also, since the deposits are usually smaller and more numerous than those of a commercial bank, it is more feasible to estimate what the withdrawals will probably be in a given space of time. For all these reasons, the reserve in a savings bank is usually a much smaller percentage of the deposits than the reserve in a commercial bank. Because of the comparative stability of its investments, the savings bank is able to invest its deposits under fewer restrictions than a commercial bank, and in many places may make money by all sorts of investments, while the commercial bank is strictly limited to commercial paper.

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* The impossibility of an outsider deciding on the quality of the commercial paper held by a far distant branch of a great bank is given as one of the reasons why an external inspection of our banks would not work well in Canada.

Interest on Deposits.

The savings bank, in addition to providing safe-keeping for money, offers interest in order to attract depositors. As a result of having so much larger a percentage of its assets invested, the savings bank is able to pay interest on deposits; the strictly commercial bank usually does not. Its attraction for the depositor is its convenience and its services to him in discounting his commercial paper.

In Canada, under our system of nation-wide banks, the savings and the commercial banks are inextricably fused. Practically all our chartered banks discharge both functions. Yet it is possible to see approximately how much of their deposits are savings deposits and how much are commercial deposits, by comparing the deposits payable after notice with the demand deposits. Some banks which do more city than country business wlil be found to have a larger proportion than the average of demand deposits; others which devote more attention to country business, a smaller. If one investigates the comparative amounts for the past decade, he will find that about two-thirds of our deposits are savings deposits and one-third commercial. Our Canadian arrangement is a happy one, in so far as it enables our banks to use their savings deposits in furthering the business of the country more actively than would be done by purely savings institutions.

In Canada the usual rate of interest paid by chartered banks on savings (or time) deposits is three per cent.; on commercial deposits no interest is usually paid, though in some cases where specially large balances are kept, a low rate of interest is paid under a special arrangement.

Branch Banks.

An important feature of our banking system is the branch bank. Our banks are banks of branches, with their centres at some important city, operating for the most part over wide expanses of territory and, in the case of our larger banks, all over the Dominion. The advantages of this system to the business public as compared with the system of small individual banks existing in the United States, are manifold. Under our system money flows much more readily from one place to another than under theirs; thus the rate of interest varies as between East and West less with us than with them. Our affairs are in the hands of experts; we have the advantages over the Americans that large scale producers have over small scale producers. Our banks are able to place their money more wisely than are the American banks, because our banks have a nation-wide vision and a nation-wide *clientèle*, which the American banks have not. Also our banks are more easily able to collect money in one place where it is plentiful and invest it in another place where it is scarce than are the American banks. All this implies a great economic advantage; and has, no doubt, contributed largely to the rapidity of settlement in the Canadian North-west.

Clearing Houses.

We have said already that one of the great purposes of the bank is to make credit do the work of money, thus economizing the use of money through the use of its bank notes and deposits as media of exchange. Banks have within the past generation been rendered much more efficient economizers of money through the use of clearing-houses.

Up to about a generation ago, when the customer of a bank paid into his bank the note or the cheque of another, the messenger of that first bank went around daily and collected from the debtor banks the amounts of money due from them. They in turn sent their messengers to his bank and to each other to collect the amounts of money due to them on notes and cheques which had been deposited with them. This was a very clumsy system, requiring a great deal of the messengers' time and much counting and recounting of money. Also it had in it a certain element of danger, as the messenger was commonly known to have much money on his person. This invited robbery. Finally it tied up a great deal of cash in making these daily settlements.

At last the plan was devised of having representatives of all the banks in a community meet daily at some convenient centre in the town, which was called a clearing-house.* Here they were to bring the notes and cheques on each other which they had received the previous day, all neatly tied up, with the total amount stated thereon. If there are ten banks doing business in a place the representative of each bank goes to the clearing-house with nine packages of notes and cheques on the other banks.

In an ordinary day's transactions it is found that some of the banks are debtors—the amount of paper which they hold on other banks is not so great as the amount which the other banks hold on them—and some are creditors——holding more paper (i.e., notes or cheques) on other banks than other banks hold on them. Debtor banks must, under the rules of the Canadian Bankers' Association, settle their balances by twelve o'clock and creditor banks must receive the amounts due them by half-past twelve. Balances are paid with Dominion notes that are negotiable only between banks, by draft on Montreal, and sometimes by draft on New York. All the banks are most particular to pay their balances every day, as failure to do so would immediately be published and would necessarily result in a run on the bank and its probable failure.

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* The Supreme Court of Pennsylvania defines a clearing-house as follows:—"It is an ingenious device to simplify and facilitate the work of the banks in reaching an adjustment and payment of the daily balances due to and from each other at one time and in one place each day. In practical operation it is a place where all the representatives of the banks in a given city meet, and, under the supervision of a competent committee or officer selected by the associated banks, settle their accounts with each other and make or receive payment of balances, and so "clear" the transactions of the day for which the settlement is made.

Paper representing enormous business dealings passes annually through the clearing-houses; the amount of clearing-house transactions is regarded as perhaps the best index to the volume of business done in a community, as the records of a very large percentage of all business go through the clearing-houses. This is truer of the United States than of Canada, since with us a considerable share of the business is transacted within the different branches of a single bank, which in the United States is done with different banks. Mergers between our banks must also necessarily tend to reduce the amount of our bank clearings.

The fluctuations of the clearing-house returns are considered one of the best indications of the degree of prosperity of a country. Any depression causes them to fall, or at least to remain stationary; a period of prosperity leads to a rapid increase in the amount of bank-clearings.

The bank clearings of the Dominion have grown from $979,000,000 in 1893 to $7,195,000,000 in 1911, and $9,143,000,000 in 1912. An increase of bank clearings has occurred in every year of the past decade, except in 1908, the year of depression, when the total was $4,142,000,000 as against $4,313,000,000 in 1907. Since 1908 the clearings have grown by leaps and bounds, and have more than doubled in four years—a marvellous advance that speaks volumes for the progress of our country and the energy of our people.

Economy of Money Effected.

How great a saving in the use of money has been effected by the establishment of the clearing house may be illustrated from the statistics of the New York clearing-house. In the year ending Sept. 1, 1907, over $95,300,000,000 in cheques and drafts passed through the clearing-house, while the total money balances paid amounted to $3,800,000,000, or only 4% of the business transacted. There is every reason to believe that with the increase in the number of people having bank accounts, the use of money in business transactions will continue to decline, and a larger and larger percentage of business will in all progressive communities be carried on by the use of credit instruments. "Money," it is said, "is only the small change of commerce." Some economists have even had visions of a future society in which our money will have ceased to exist, and all obligations in a community will be discharged by a transfer of credits in some enormous book. In many small transactions, however, the expense attending the writing of cheques and the transferring of credits will always make the use of money a more economical method of discharging one's obligations.

N.B.—Students specially interested in the Canadian Banking System are advised to read Sir Edmund Walker's History of Banking in Canada, Mr. H. M. P. Eckhardt's Rational Banking System, and the three reports on the Canadian Banking System published by the National Monetary Commission of the United States. The latter may be procured from the Superintendent of Documents, Government Printing Office, Washington, for a postal money order or express order for eighty-five cents. These books, which should be in every banker's library, are as follows: The History of Banking in Canada, by R. M. Breckenridge; The Canadian Banking System, by J. French Johnson; Interviews on the Banking and Currency Systems of Canada.

ECONOMICS

EXAMINATION QUESTIONS

ECONOMICS.

LESSON 9.

1. What is "credit"? Why are credit prices higher than cash prices?

2. Explain how a failure of credit occurs and trace its consequences.

3. What is a bank? What are the functions of a bank?

4. How does a bank-note differ from other promissory notes? Explain how these differences make it a convenient substitute for money.

5. Point out how the bank derives a profit from note issue, and show the special importance of note issue to a young bank.

6. Just why does one accept a Canadian chartered bank note as freely as a Dominion note? What safeguards protect the Canadian note-holder?

7. Compare these with any analogous safeguards in other countries.

8. Why is the note-holder a preferred creditor as compared with the depositor?

9. Why does the Government allow the banks to issue notes, instead of making considerable profit for itself by replacing their notes with Dominion notes? (Of course it would have to alter the "Act respecting Dominion Notes" in order to do this.)

10. Show clearly how credit is created in the modern bank.

11. Distinguish the savings bank from the commercial bank. What classes of investment would each of them naturally prefer? Why do savings deposits draw interest, while commercial or demand deposits do not?

12. What are the advantages of the branch bank system as compared with the small banks of the United States? Have you anything to say on the other side?

13. Explain the functions of the clearing-house, and show how it economizes the use of money.

ECONOMICS

LESSON 10

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ECONOMICS

LESSON X.

International Trade—Free Trade and Protection.

THE latter part of this lesson deals with a highly controversial topic. The writer has tried to state, fairly and impartially, the case for both sides, so far as is possible in so brief a treatment. He disclaims any attempt at proselytizing, while believing that it is well for both Protectionists and Free Traders to know what is to be said on the other side of the question.

Definition of International Trade.

In dealing with this subject, as indeed with most others, one must begin by a definition. What do we mean by "International Trade?" What is the economic definition of a nation? Bagehot says that a nation, in the economic sense, is a group of producers, within which labor and capital freely circulate, and adds the corollary that labor and capital will not, as a rule, migrate beyond the boundaries of the nation. Hence, the essential characteristics of a nation, from our point of view, are: (1) Free circulation of labor and capital within that particular group of producers; (2) more or less complete immobility of all the agents of production as regards transfer to other groups.

Causes of Immobility of Labor and Capital.

The next question is: What creates this immobility? Many things help to do so. First, there is always the cost of transportation from country to country. Second, there is usually the difference of language, which puts very great difficulties in the way of trade between two countries. (For instance, there is very little trade between ourselves and Russia. We should do much less trading than we do with the United States if the Americans spoke Russian.) Next, there is generally a difference of currency, which necessitates processes of calculation when trade is carried on with another country. Again, there is in one country a very general ignorance of the trade opportunities of another. Lastly, there are artificial obstacles to international trade in the form of tariffs.

Now, on the other hand, it is obvious that this immobility is not complete, else we should have no International Trade at all. In fact, the present age is peculiarly characterized by the great and increasing freedom of movement possessed by capital. Yet there is a degree of difficulty in effecting the transference of commodities which interferes substantially and generally with their exchange over the whole range of industrial competition.

Reasons for International Trade.

Why should there be any international trade at all? Why should not each nation produce all it wants for itself? Simply because certain commodities can be produced more cheaply in some nations than in others. Wheat, for example, can be produced more cheaply in Canada than in England; woollen goods can be produced more cheaply in England than in Canada. So, from the economist's point of view, Canada should specialize on wheat and import her woollen goods from England. England should specialize on woollen goods and import her wheat from Canada. In order to understand international trade from the simplest possible example, let us suppose we have only the two countries, England and Canada, trading in only the two commodities, wheat and woollen goods.

International Trade: First Case.

Now suppose it costs 10 units of effort (i.e. labor and capital) to produce a unit quantity of wheat in Canada, and 20 units of effort to produce the same unit quantity of wheat in England, and suppose it costs 15 units of effort to produce a unit quantity of woolen goods in England

and 20 units to produce the same in Canada. Suppose Canada wants 1 unit of wheat and 1 unit of woollen goods. It will cost her 30 units of effort to obtain them if she produces them for herself. Similarly, it will cost England 35 units of effort to obtain these same quantities of wheat and woollen goods. This makes a total of 65 units of effort expended if each of the two countries produces for itself.

Now, let Canada produce all the wheat and England all the woollen goods. Canada can produce the 2 units of wheat for 20 units of effort, and England the 2 units of woollen goods for 30 units of effort—a total of 50 units of effort.

Thus, then, 15 units of effort are saved when each country produces that commodity for which it is best fitted. From these 15 units of effort the cost of transportation—the cost of transporting the unit of wheat from Canada to England and the unit of woollen goods from England to Canada—must be deducted. The gain accruing from the saving of effort will be divided between the two countries concerned.

The division of labor between countries is, then, economically profitable, just as is the division of labor between individuals.

International Trade: Second Case.

Now, the foregoing case, where each country has an absolute advantage over the other in one of the two commodities interchanged, is the most general case where international trade occurs. Cairnes has stated the law of comparative cost so as to include another important case.

He says: "The one condition at once essential to and sufficient for the existence of international trade, is a difference in the comparative as contradistinguished from the absolute cost of producing the commodities exchanged."

In order to explain this more clearly, let us first take a parallel case from the life of individuals. Suppose that two men can both make shoes and hats, and that one is more skilful than the other in both employments. He is able to make a hat with 2 units of effort, his rival with 3 units of effort. He is able to make a pair of shoes with 1 unit of effort, his rival with 3 units of effort. Thus, his advantage in the case of shoes is greater than in the case of hats. Supposing each of them needs a hat and a pair of shoes, it will be profitable that the first man hand over to the second the making of hats, in which his advantage is less, and confine himself to the making of shoes, in which it is greater. The abler man can make his hat and his pair of shoes by himself with 3 units of effort, the other with 6 units. Altogether, the expenditure of effort will be9 units. But if the better man makes shoes only, he will be able to make 2 pairs with 2 units of effort, and the poorer man will make 2 hats with 6 units of effort—a total of 8 units. There will be a saving of 1 unit of effort—less the cost of transportation.

Now, suppose we take the case of two nations in a similar position—one superior to the other in producing both the commodities under consideration. Suppose that the cost of producing a unit quantity of wheat in Australia is 10 units of effort, in New Zealand 40, and that the cost of producing a unit quantity of wool is 30 units of effort in Australia and 60 in New Zealand. Suppose that each nation produces just for itself, and that New Zealand needs 1 unit of wool and 3 of wheat, and Australia 1 unit of wool and 1 of wheat. Then New Zealand will have to expend 180 units of effort to produce by itself what it needs and Australia 40 units of effort to produce what it needs—altogether 220 units of effort. After awhile Australia begins to concentrate on the commodity in which it has the greatest proportional advantage—wheat—and produces enough of that for both countries, and New Zealand devotes itself to the production of wool, and they exchange surplus products. Then the 4 units of wheat required cost Australia 40 units of effort, and the 2 units of wool required cost New Zealand 120 units of effort. Thus we have the same goods produced for 160 units of effort, which cost previously 220 units of effort —a saving of 60 units of effort. Here, again, the cost of transportation must be taken into account as a partial set-off against the gain due to international trade.*

So, in 1849, Australia specialized on the production and export of gold and imported dairy produce all the way from Ireland. Although dairy produce could be produced in Australia at absolutely lower cost than it could be imported from Ireland, yet the comparative advantage of investing labor in gold was far greater. So the costs to be compared are costs of comparative production in the countries concerned. Ireland received in exchange for her butter gold more cheaply than she could have produced it herself, for her deposits of gold are small and mining very expensive.

This, however, is an exceptional case. In the great majority of cases, international trade arises because of an **absolute** difference in the cost of production of two commodities in two nations.

Economic Advantages of International Trade.

Looking at the subject in a more concrete way, we may say that a nation derives the following advantages from foreign trade:

1. It is able to procure commodities which it is absolutely unable to produce itself. This, as will be seen from the next point, is a comparatively rare case.

2. A nation obtains commodities which it could not produce without a tremendous cost of production. Adam Smith says, "By means of glasses, hot-beds, and hot walls, very good grapes can be raised in Scotland, and very good wine, too, can be made of them at about thirty times the expense for which at least equally good can be brought

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*These proofs are in both cases given for only two nations trading in only two commodities. They are, nevertheless, applicable to all nations and to all commodities, though international trade is in practice ever so much more complicated than in our examples.

from foreign countries.'' Many commodities could not be produced cheaply enough to attract consumers except through international trade.

3. The productive force of each community is set free for application to those natural agents and materials which offer the best chance of high returns, so that the efficiency of each productive unit is much increased.

4. The concentration of special branches of production in one place leads to further gain, as is implied by the law of increasing returns so generally applicable to manufactures.

We have now seen the advantages of international trade. The next question to be considered is what determines exchange values in trade between nations? What proportion of the economic advantage goes to each of the nations concerned?''

Distribution of Gain from International Trade.

First, it is evident that no country will exchange with another unless she derives some profit from so doing. Now, reverting to our first example, we find that the gain by international trade in that case was 15 units of effort. If this gain went all to one party in the exchange, the other party would refuse to exchange at all. Hence, the 15 units must be divided. Both countries will get the goods exchanged somewhat cheaper than if they produced them themselves, but somewhat dearer than the country actually producing them.

Within these two limits, then, the actual cost of production in the one country, and what it would have cost to produce the article in the other country, exchange-values will fluctuate, but naturally that country will get the best of the bargain whose desire for the product of other countries is least, and for whose commodities there is in the other countries the greatest demand. For example, take the case of United States cotton. England, as at the time of the American Civil War, has to have this cotton to keep her cotton mills going. So Englishmen have for some time been experimenting to produce cotton in their own tropical possessions; but so far no very great quantity has been raised—not such as to render them independent of the United States. Consequently, England must pay dearly for United States cotton; but there are other commodities which England can sell dearly to other countries.

Therefore, a country desiring few foreign commodities, and having a great demand for those which it produces, gets its imports cheaply. Also, the more markets a country has for her exports, the more cheaply will she obtain her imports. This is true, even if some of the countries which take her exports have none of the commodities which she desires to be sent to her in return.

International Trade in Barter.

International trade is fundamentally an exchange of commodities—barter, since no government can make its coined money circulate outside its own dominions. That coined money—if indeed it is "standard" money—money whose commodity value is equal to its face value—may circulate throughout the world at its commodity value. But this is not at all on account of the Government's stamp upon it. Uncoined gold and silver—especially the former—in the form of ingots or bars, will do the same. In this form it is generally known as bullion, and some economists call it money-material, because it can easily be melted and coined into whatever currency is required.

This gold, whether in coin or bullion, is, in international just as in local trade, a universally desirable commodity, and whenever it is necessary to pay off international balances, they are liable to be paid off in bullion, just as the balances between the debtor and the creditor banks at the clearing-house are paid in money. Standard gold coin or bullion is what we may call international money.

Foreign Exchange.

We do not, however, desire to send gold coin or bullion across the sea unless it is absolutely necessary. There are several expenses in so doing: first, the freight charge; second, the insurance, or charge for risk; third, the interest on the money for the time it is in transit; fourth, the loss by abrasion; fifth, the expenses of packing and unpacking, cartage, etc. Just as banks find it cheaper to have clearing-houses than to discharge all their debts to each other in coin, so New York people, let us say, who have debts to pay in England, prefer to send a slip of paper—a bill of exchange—across the sea, rather than be compelled to ship coin.

Thus if A., of New York, has sold $500 worth of goods to B., of Liverpool, A. has a right to expect from B. a remittance of money to the amount of $500, or the honoring of a Bill of Exchange for $500. To explain the last-mentioned plan of his getting paid for his goods, we will understand that while A. is in the position of having money coming to him from Liverpool, there are in New York other men who are in exactly the opposite position. That is, they owe money in Liverpool. The Bill of Exchange would simply represent an order of A. on his customer in Liverpool, directing him to pay the amount to someone in Liverpool. Now, this someone in Liverpool may easily be a person to whom the other New Yorker is indebted. A. can, therefore, realize on his sale to B. by selling to this other New Yorker this Bill of Exchange on B., and thus the debts are cancelled by the payment of money in Liverpool instead of having the money come from Liverpool to New York and go back from New York to Liverpool.

Bills of exchange are defined in Pratt's "Work of Wall Street" as "written orders drawn by one person on another who owes him money, generally for merchandise purchased from him, directing him to pay a specified sum at a specified time to a specified person. Bills of exchange are negotiable, being transferable by indorsement the same as drafts and cheques." They become articles of merchandise like the products whose sale produced them, and are thus bought and sold like wheat or cotton or stock. Exporters have bills of exchange on their foreign debtors for sale; importers buy bills of exchange in order to be able to pay their debts to their foreign creditors.

There is, therefore, in a city like New York a regular market in bills of exchange. If importations and exportations are about equal, as well as the other items of the international balance, then the rate of exchange will be about par—a bill will be bought or sold at about $4.86 2-3 per £1—the value, measured in American money, of the gold in the sovereign. If, however, importers are buying more freely than exporters are selling, there will be fewer bills of exchange on London for sale, and they will command a high price because importers will be struggling to secure these in order to meet their London obligations. They will accordingly offer more than $4.86 2-3 per £1 for a bill of exchange; they will offer up to the point at which they may as well send the gold across to Europe. They will be ready to pay up as high as $4.8875, since the total cost of sending bullion across the ocean is about two cents per £ sterling.

At other times exporters are selling goods in England more freely than importers are buying. As a result, there are more bills of exchange on London for sale than the purchasers want. The exporters, however, prefer to get even $4.85 per £1 for these bills rather than to get the gold due them in London, and have to bring it back at their own expense. If they have to do so, they are just a trifle worse off than if they had accepted $4.85 for their bills, since the amount due in London is calculated in £'s—$4.86 2-3 to the £1—and they have to pay about two cents per £1 for bringing their gold across the water.

The Equation of Indebtedness.

The rate of exchange is decided not merely by the imports and exports, but by what may be called the **equation of indebtedness,** the whole financial relationship of one nation with another. Some of our modern Protectionists have thought that the balance of trade was favorable or unfavorable, according as the exports exceeded or fell short of the imports. But in this they have ignored the enormous mass of other financial transactions. For instance, a storekeeper's books may show an enormous credit balance if he has lent money during the year, or a large debtor balance if he has borrowed it. But this gives no adequate information about his financial standing. So it is with nations.

The Case of England.

We are told that the imports of the United Kingdom during the past few years have been from 150 to 200 millions sterling more than its exports. Does this necessarily mean that England is running into debt; that she is spending more than her income? By no means. She receives annually over £100,000,000 as interest on her foreign investments, and about £70,000,000 as freight charges on foreign goods carried in British ships. These balance up her accounts, and we see that Great Britain is not going behind after all.

The Case of the United States.

On the other hand, the exports of the United States are something like $500,000,000 greater than their imports. Does this necessarily mean that the United States is becoming a great creditor country? Not at all. We must consider (1) that she pays England an enormous sum in freight charges for the carriage of her bulky products across the sea. (2) The United States is still a debtor country, and a large part of her surplus exports go to pay the interest on her debts. (3) The lavish expenditure of the many Americans who travel in Europe every summer and the remittances which they receive from home, absorb a very considerable part of the surplus exports. (4) The remittances made to countries like Italy and Ireland by Italians and Irish who have settled in the United States, are quite an appreciable factor when we come to draw up the national balance sheet.

Then, too, when a country is actually borrowing from another, as we borrow from England, the amount of the loan will figure among our imports, while its interest and the repayment of the principal when that falls due, will be included among our exports.*

It is, then, impossible to decide merely from looking at the amount of the imports and the exports of a country that it is prosperous or the reverse. A country may have a large excess of imports over exports, and be very prosperous, or a country may have a large excess of exports over imports and be very prosperous. A country, however, which has a balance of indebtedness against it, will have sometime or other to settle up by surplus of exports, unless its imports are in payment of the principal or interest of some debt already due to it.

The Case of Canada.

Now to glance for a moment at our own position, we notice that our imports average quite $150,000,000 or $200,000,000 a year greater than our exports. Canada is not, like Great Britain, a creditor country; on the contrary it is a debtor nation. It has no interest coming in from other countries, but rather pays to them interest on loans. How, then, are other countries repaid for this enormous excess in imports? The truth is that they are not paid at all at the present time. They consent to wait for their money, receiving interest on it for the period of waiting. Our promises to pay are our securities, whether government, municipal or corporation. The securities we issue in London markets represent future exports of commodities.

To put the statement in another way, we may say that "**a country can create an immaterial export by means of its securities, the value of which it has at a future date to**

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*The ratio of foreign exchange is, of course, affected by all these other items of the international balance, just as much as by the balance of trade.

meet by sending out an actual export of equal value—interest, of course, being met by exports in the meantime.''

Class Interests in Different Nations.

The influence of foreign trade on the fortunes of different classes in the nations of the world is worthy of our serious consideration.

It is evident that imported commodities are obtained at a cheaper rate by means of foreign trade, and thus the consumers of such commodities are benefited. The imports of food, especially as in the case of England, have supplied the labourers with cheap food. By thus increasing the supply of food stuffs, they have lowered the price of home-grown food, and as a result the rent of land has declined. Consequently owners of land in all old and long-settled countries have advocated protection, as the general tendency of freedom in foreign trade in such countries is to lower the value of land. On the other hand, in new countries, landowners are generally inclined toward freedom of exchange, as in Canada and the United States, because, on the whole, tariffs are moulded in the interest of the manufacturers. The prices of what the farmers of a new country have to sell are fixed on purely economic grounds by the world-markets of Liverpool and London, while the prices of what they have to buy are artificially increased by the protection accorded to the manufacturers.

With regard to manufactures the case is somewhat different. Here the principal argument for freedom of foreign trade is that under such conditions capital would be invested only in the industries for which the country was most fitted, and would thus earn a higher natural return without taking its artificial dividends out of the pockets of the consumers as it does now in protected countries.

General Rule of Free Trade.

So, then, from what has been said one deduces a practical rule of ''free trade'' from the strictly economic reasoning. This means the removal of all artificial restrictions on or encouragements to any particular industry; the levying of duties for revenue only; the levying of internal or excise duties on home-produced commodities whenever those commodities when imported are subject to customs duties; the abandonment of any effort to force commerce into any other than its natural channels.

The Different Schools of Free Traders.

Some Free Traders of the older school, like Bastiat, objected to State interference with any exchange, on the ground that every man had a right to exchange his products as he pleased. Protection was to such men only a new kind of theft; and consequently smuggling was, according to them, a species of resistance to tyranny. This, however, is an extreme position.

Other more practical men justify their support of freedom of exchange by appeals to specific experience. The Anti-Corn-Law lecturers dwelt on the actual distress of the English people and particularly on the miserable condition of the agricultural labourers. Only the specific evils of protective tariffs were considered, and indeed it was the failure of the harvest of 1845 which finally decided Peel to abolish the Corn Laws. There can be no doubt that this reasoning is most effective in actual political life, but one must remember that it is impossible to apply this experimental method strictly to social phenomena, because when the free trader points to certain losses as due to protection, the protectionist will reply that they are due to something else, and neither one can establish his case with any certainty. Hence the theoretical argument is necessary.

Some modern free traders are content to say that free trade is the outcome of social development, that the most highly organized country is the free trade country. They admit that protection has been and may be now necessary as a temporary expedient in backward and undeveloped countries. For an advanced system of industry, however, free exchange is beneficial and should be the ultimate object to be attained.

Economic Argument for Free Trade.

The general line of theoretical reasoning in defence of free trade is simply this: in every particular international exchange there is necessarily a gain to each party concerned; therefore in the sum total of international exchanges there must be an enormous gain to each party concerned. Protective duties as diminishing or hindering this gain are necessarily injurious, as all impediments to transfer reduce the gain from exchange. The loss which results from protective duties exactly resembles that from difficulty of transport, and brings back no compensating advantage. So, they say, protection is foolishness. They point out that strenuous efforts are made to remove natural obstacles to exchange, and then people immediately set to work to establish artificial obstacles in order to "protect" national industry. So we are told that after the St. Gothard tunnel had been built through the Alps, the people of South Germany petitioned the Government to lay higher taxes on Italian products so as to offset the cheap freight rates which the tunnel had made possible. Indeed it is quite clear that the cheapening of transport in late years has had a great deal of influence in producing the protectionist tendencies of the day.

Economic Argument Against Protection.

In conclusion, one must point out in detail the evil results of protection, from the free traders' point of view.

The wealth of each of the communities prevented from trading freely with each other is reduced, or at least is rendered smaller than it might have been, as a consequence of the restrictions placed upon trade. These restrictions are imposed for the benefit of the producer, and they usually increase the price to the consumer by approximately the amount of the duty. Some American protectionists contend that there is no increase in price, but any price-list proves the contrary. And even if what they claim were true, it would only show that as American manufacturers could produce as cheaply as European, protective duties were not needed. Besides increasing the cost to the consumer, protection leads to an artificial and less economic distribution of the productive forces of the nation. It is beyond question that a great saving of productive power would accrue to the world at large by the concentration of manufacturing industries at those places which are favoured by technical and economic conditions.

The Case For Protection.

In a purely agricultural nation, according to List, the great German economist, a part of its productive strength lies unused. This is due to the fact that many of the people have no aptitude for agriculture, but have to turn to it or leave the country. Therefore, such a nation must attempt to develop its own manufactures, first for its home market and then for export. This will lead to the formation of a considerable mercantile marine for the purpose of handling these goods, and the acquisition of colonies as markets for them. So a many-sided culture is built up and the nation becomes self-sufficient.

Trade, he says, is war. For a commercially undeveloped nation like the Germany of his time to wage this war with a highly developed nation like the England of his time, was like a boy challenging a grown man to fight.* The economically inferior nation must first strengthen its energies by protection and the upbuilding of its industries, before it can compete on equal terms with the economically superior. List, however, favoured free trade between people of the same language and blood. To his doctrines was due, in some degree, the foundation of the Zollverein or Customs Union of Germany, which has led to the establishment of the German Empire. The Zollverein is important to us, inasmuch as it is regarded by English Tariff Reformers as the model on which a united British Empire may be built up by inter-imperial free trade, combined with protection against the outside world.

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*List's great book, The National System of Political Economy, appeared in 1841, when England enjoyed an almost undisputed predominance in industry. The student would do well to refer to an encyclopædia for an account of this remarkable man.

Results of Protection in Canada.

Taking our own experience of a Zollverein in Canada, there is no doubt that protection has resulted in drawing our provinces closer together, and in keeping among us many who would otherwise have gone to the large cities of the United States. But it is highly probable that our agricultural population would have been larger if agricultural machinery and supplies were allowed to come in from the United States duty free, and if our farmers had free access to the American market.

The idea of a Zollverein is at first sight very attractive, and the institution seems in some cases to have justified itself. But it has serious drawbacks. It implies the existence in a country of a government that is wise enough to know just what industries need development and courageous enough to refuse protection to those who do not need it. Hence, while the protective system works well in Germany, where there is a strong, non-partisan government, it does not work nearly so well in a democratic country like the United States or Canada, where the tariff is framed rather in accordance with the relative strength of various conflicting interests, than with a view to the broad lines of national development. "All the difficulties of representative institutions," says Mr. Bastable, "are increased by the adoption of protection, which diverts attention from the main issue of good government to the impossible task of pleasing the conflicting interests which seek encouragement and support."

In Bolles' "Financial History of the United States" the following passage occurs: "The history of tariff-making has not been particularly honourable, in all its details, to any party or interest, and has too often become a personal fight by manufacturers against the public and each other. The manufacturers of woollen goods want free wool and dye-stuffs, while those who produce these articles demand protection. The manufacturers of ironware desire that ore should be brought in free, while the ore producers desire a protective tariff.'' So our tariffs, as they exist to-day, are not ideal tariffs wisely aiming at developing a many-sided civilization in our country, but are largely the resultant of the conflict of organized groups of individuals, each bent upon his own ends. There is only too much reason to fear that many of those who shout for Preferential Trade, both here and in Great Britain, do so only in the hope of serving their own individual and class interests, rather than those of Canada, Great Britain and the Empire at large.

The Alleged Ultimate Economic Gain.

List admits, as he must, an immediate economic loss resulting from protection, but asserts that if protection is wisely applied the ultimate economic gain much more than counterbalances the immediate economic loss. We might compare his argument to the following: If a family compelled its children to get out and work at the minimum legal age of fourteen, there would be an immediate economic gain in the wages earned by those children. But there is no certainty that in the long run the economic position of the family would not be improved if it allowed the children to remain at school, develop their energies and train themselves for a higher class of work. In the same way there is no certainty that the ultimate economic position of the State as a whole will not be better if it develops all its energies under a wise protective system, than if it seizes the more obvious and immediate advantages of the free trade system.

Ultimate Economic Gain From Protection Uncertain.

On the whole, if we look at the question of protection and free trade from the purely economic point of view, it seems that the free trader has the advantage on his side.*

There is no doubt that interference with trade means a certain inevitable economic loss, while the economic gain is always more or less uncertain, speculative and problematical. Theoretical cases may easily be taken which will show a balance of net gain from protection, but it is an immensely difficult undertaking for the careful scientist to show that a certain duty imposed to aid home manufacturers and continued—as it must be if it is to have any considerable effect—over a period of years, perhaps a generation, has resulted or is likely to result in a net gain to the community. There are too many varying factors to be taken into account. Perhaps the best economic argument for protection in Canada is the fact that protection has enabled us to secure capital from abroad for the development of our industries which could not have been secured under free trade. Thus our industries may have got into operation at an earlier period of our history than would have been the case under a free trade policy, and may have retained in the country many people with a taste for manufacturing who would otherwise have gone to the United States.

The Political Argument For Protection.

While this is the case, there is another and a stronger side to the argument—the political side: if a man came to me and said, "I don't admit that protection involves an ultimate economic loss, but even if it did I should still vote for it, because it is a great uniting force in the country and has made us economically independent of the United States,'' I should not be in the least disposed to consider him an unintelligent, prejudiced person. He may or may not be ready to admit the probability of ultimate economic loss from protection, but whether he does or not he is perfectly entitled to give the preference to political as against economic considerations. We do not usually call a man a fool for choosing an occupation for himself on other than merely pecuniary grounds, and we certainly have no right to disparage his intelligence if he casts his vote on political rather than on economic grounds. There has been too much denunciation of protectionists as transgressors of economic laws. If they are, then every man who accepts a less highly paid in preference to a more highly paid position is a transgressor of economic laws. Economic ''laws'' should rather be called ''rules'' for our guidance in deciding on economic questions; they are not moral mandates. Some of the older economists and some of our modern publicists who have read only the older economists, are disposed to argue as if these economic laws were immutable and their observance as obligatory upon us as that of the Ten Commandments. This is simply ridiculous. A man has a perfect right to say that the political dangers of a certain course of action are, in his opinion, greater than the possible economic advantages, and to vote accordingly. Of course, he may or may not be right in his contention.

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*Free trade is, for all practical purposes, synonymous with a purely revenue tariff. Such a tariff either imposes duties on goods which are not produced within the country, and so confers no special favors upon home manufacturers, or, as in the case of our tobacco and liquor duties, it imposes the same rate of tax upon the home-produced as upon the imported commodity. Thus the home-producer gets no protection—no special favor as compared with the foreign producer. Practically all the so-called free-trade countries raise money by revenue tariffs, and the Dominion of Canada would in all probability have to do likewise on account of our tacit agreement that the product of direct taxes shall go to the Provinces.

The Ethical Argument Against Protection.

The ethical argument that it is wrong for the state indirectly by means of a protective tariff to take one man's property and give it to another, is very difficult to meet, if one is arguing with extreme individualists of the school of John Bright, in whose opinion the State existed merely to do police duty for the citizens, ensuring the safety of their lives and property and securing for them freedom to pursue their occupations as they will. The expenses of the State are to be met, according to this school, by certain charges levied upon the citizens in proportion to the incomes or the capital which they enjoy under the protection of the State, and the State has no right to take from any citizen a greater amount in proportion to his income or capital than it takes from any other citizen. If we adopt this view of the State, then protection is unethical; but so are succession duties and all other taxation graduated so as to fall proportionately more heavily on the rich than on the poor. The liberal free traders of England with their great programme of social reform, are as unmoral as the Conservative Tariff Reformers, since both policies involve taking the property of one class to give it to another.

Summary.

The fact is that practically no one to-day consistently clings to this antiquated point of view, though many people accept it on occasion. Our economic and sociological studies, not to mention our religion, tell us that we are all "members one of another," that an unhealthy condition in one part of society is an injury to all, and that the State is justified in placing special burdens on certain sections of the population if the result contributes to the general welfare economic, social, or political of the whole society. By that criterion—the greatest good of the greatest number—protection, as well as the whole social legislation of the modern State, must stand or fall.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON X.

1. What is the economic definition of a "nation?" What are the causes of the immobility of capital and labour as between nations?

2. Prove that there is an economic gain to two nations when each devotes itself to those branches of production in which it is most efficient, and barters its surplus products for those of the other.

3. Show that this economic gain exists even when one nation is superior to the other in all kinds of products.

4. What are the chief economic advantages resulting to the trading nations from international trade, and how are these advantages likely to be distributed between the nations concerned?

5. How are balances settled in international trade? What are Bills of Exchange, and how is the rate of exchange determined?

6. What do we mean by the "equation of indebtedness?" Explain the great excess of imports in the case of England, of exports in the case of the United States, of imports in the case of Canada.

7. Explain the agitation for free trade among our Western farmers and compare their position with that of farmers in England.

8. What are the main arguments of the various schools of Free Traders? What is the general economic argument for Free Trade versus Protection?

9. What are List's arguments in favour of protection for undeveloped countries? What is the Zollverein, and why is an Imperial Zollverein advocated by persons who desire a "United Empire"?

10. Is there an economic case for Protection? Which is the stronger—the economic or the political case for Protection?

11. "The free trader is a cosmopolitan in his sympathies; the protectionist is a nationalist." Discuss.

ECONOMICS

LESSON 11

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ECONOMICS

LESSON XI.

Distribution—Rent.

IN the previous lessons we have dealt with production and exchange. Now we come to deal with a third great division of economics, which is even more technical and open to controversy in its character than those which we have already treated. This third division is called **distribution.**

Distribution, in its economic sense, means the division of all produced wealth among those who have directly or indirectly contributed to that production. The economic term has nothing whatever to do with the popular sense of the word. One may say, in popular language, that a railroad is a distributor of commodities, but in the economic sense, such distribution of commodities is only a particular type of production—the creation of place-utilities. In the same way we might speak of the proprietor of a great store as a distributor of commodities; in economic language, however, he is a producer of possession-utilities.

If one considers the process of production and the persons who are directly or indirectly concerned in it, one will find that there are four distinct functions concerned in almost any act of production; these functions are usually performed by four different persons, though in certain cases two or more of them may be discharged by a single person. The product, may, therefore, be divided into four parts.

Rent.

1. Any act of production must go on somewhere—on some piece of land or other. Now in our civilization almost all land (at least in settled communities where production is going on and where a labour force exists) is private property which no one can use for productive purposes without permission from the owner. The owner of

land, then, which is from its situation or its fertility specially suitable for manufacturing purposes or for agriculture, is able to secure from the person who desires to carry on production, but does not possess the land suitable for such production, a part of the product in return for allowing him to use that land. This part of the product paid to the owner of land for the use of that land is known as rent.

Interest.

2. Then, too, the man who wishes to begin the manufacture of a certain commodity has, besides paying rent, to erect buildings and purchase machinery and raw material before he can begin to produce. If he has no money of his own, he may, if his credit is good, procure money from those who have it, on his promise to pay them back their money with an additional payment which we call interest. This additional payment must, of course, nominally come out of the sale of the finished product, or at least be advanced out of the prospective sales to be recouped when they are realized.

Wages.

3. The prospective manufacturer must have people to work for him, and as they will not do so for nothing he will have to give them a share in the product of labour—a share known as wages. He will usually begin paying them wages before the product is actually disposed of, but he will charge up these wages against the product.

Profits.

4. Lastly the manufacturer will expect to have after rent and interest and wages are paid, something left over for himself—which he may consider as his profits.

But it is not only the manufacturer who makes profits. It is any man owning and managing a business of his own. The farmer, whether he be tenant or landlord, whether his farm be mortgaged or not, is running a business of his own, and so is the merchant. In general we call a man who is running a business of his own the entrepreneur—

a word adopted from the French. Some economists have Anglicised the word into undertaker or enterpriser, and we often call a large entrepreneur who employs many wage- earners on his farm or in his store or factory, a captain of industry. Such a man, if noted for business ability and integrity, may run an enormous business with little or no wealth of his own.*

Combination of Functions.

Of course, a man may combine all four of these functions. Many Canadian farmers do. They own their own land, own the buildings, stock and implements, work with their hands just like a hired man on a farm and also run their business as entrepreneurs. They receive, therefore, the whole product of their labour, including rent, interest, wages and profits. This is, of course, received as a whole. The farmer does not consciously divide it into these component elements, though he may very likely (especially when he is thinking of retiring) calculate what the farm would rent for with or without its stock and implements—that is, with or without its working capital. Also, his neighbor may employ a hired man who may be just as efficient a manual worker as himself, and by deducting this man's wage from his whole income he may be able to make an approximate calculation as to how much of his total income is to be assigned to each of the four functions which he discharges.

In the same way as we have imagined the farmer dividing up his income, it is possible for a nation such as Germany or England to calculate (very approximately, of course) how much of its incomes—its total annual product of wealth—goes in rents to landowners, how much in interest to capitalists, how much in wages to labourers, and how much in profits to entrepreneurs. These amounts are ascertainable with some degree of accuracy.

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*Pierpont Morgan, the head of the so-called Money Trust, in his recent evidence before the Congressional Committee, said that he would prefer to lend a million dollars to a man with character and without securities, rather than to a man with securities and without character.

Shares Not Immutably Fixed in Amount.

The amounts of these respective shares may be largely modified by any independent society, and have, as a matter of fact, been very greatly modified during the evolution through which society has passed since the time, let us say, of the Norman Conquest. And it is not to be supposed that during all the centuries to come the distribution of wealth will be just what it is to-day.

At the present time we hear very often that the actual manual laborer does not get a share proportional to his merits in the distribution of wealth, and, to take one instance, Great Britain has recently passed a law establishing what is called a minimum wage in the coal mines—enacting, that is, that no one working in a coal mine shall be paid less than a certain wage. Whether such a law will lead to an increase in the amount of wages going to the wage earners of England as a whole is a very debatable question, but the intention at least is to raise the wages of the laborer. Another way in which this same end may be effected, is for the Government, which may perhaps be considered as a silent factor in production, to step in and take in taxes a portion of the shares of the other three partners in production, while leaving the wage-earner untaxed, or even providing him with various utilities out of the taxes collected from others. Thus in England of late years old age pensions have been provided for the poor, mainly at the expense of the wealthier classes.

These facts, then, that the laws of wealth are not immutable, and that its distribution may to some extent be changed by human progress and legal enactment, have led to bitter controversies between those who claim that our present system of the distribution of wealth treats all classes with substantial justice and does not require modification, and those who assert that at the present time the wage-earner in particular is not getting a fair share of the wealth that he produces, while the other sharers in that wealth are getting too much. In dealing with this question it will be our aim simply to put clearly before the student the leading positions of both sides.

Many of these controversies are connected with the economic doctrine of rent, the first charge in production, which we shall now discuss.

Ricardo's Theory of Rent.

The theory of rent which is practically universally accepted by economists, is known as the Ricardian theory, from the name of David Ricardo, who, although he was not the first to formulate this theory, was the one to develop it in its fullness and make it an integral part of economic science. In his "Principles of Political Economy and Taxation," published in 1817, he defines rent as "that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil." This theory really involves two subordinate theories:

(1) An historical theory as to the origin of rent.
(2) An analysis and definition of rent as it is.

No Rent At First.

Considering rent historically, it is evident that on the first settling of a country or district where land exists in abundance, there will be no rent, for no one would pay for the use of land while there exists plenty of land of equal quality as close to the markets where produce is sold, still unappropriated and at the disposal of whoever may care to cultivate it. Under these circumstances the cultivator would no more pay rent than does the man who catches fish on the open sea.

But land is variable in quality; some day all the first quality land near the market will be appropriated, and those who come to the district later will have either to take what we may call second quality land near the market, or first quality land at a considerable distance—a distance which necessitates a cost of transportation sufficient to make it a "toss-up" as to what the incoming cultivator will do. We may call this land which is first quality by fertility, second quality by situation.

Emergence of Rent.

In these circumstances there is yet a third course which he may follow. If the first quality land produces 30 bushels of wheat per acre, while the second quality land (either by fertility or situation) gives a net product of only 25 bushels (assuming that in the case of land that is second class by situation it costs him the price of 5 bushels to bring 30 to market) then he may decide on renting first quality land near the market at a rent of 5 bushels per acre—the difference in net product between first and second quality land. He will be ready to do so, because he can do as well for himself in this way as by settling on the free second quality land.

By and by the second quality land (whether by fertility or situation) will be all taken up, and now the newcomers or the superfluous farmers' sons will be driven to take up third quality land, which yields only 20 bushels to the acre. This they can get for nothing. As soon as this land begins to be settled, up goes the rent of first quality land, since some of the prospective farmers will be willing to pay 10 bushels per acre rent for the use of first quality. They will also be ready to pay 5 bushels per acre for land of second quality, since either of these courses will be as profitable as to settle on third quality land. And so, too, they may, in time, resort to fourth and fifth quality land. When fourth quality land comes under cultivation, then third quality land begins to bear a rent. In any case, every quality of land which is better than the worst under cultivation will bear a rent. The worst quality actually under cultivation at any particular time is called "no-rent" land; it is to be found on many farms along with better qualities, so that its existence is not suspected.

Effect Upon the Consumer.

What is the result upon the person who consumes the products of the land? At the beginning, when only first quality land was under cultivation, we will assume that wheat could be produced at a cost of $30 per acre; therefore, the price of wheat where land is free and is bearing 30 bushels to the acre, is presumably $1 per bushel. But when second quality land is taken into cultivation, it costs $30 to raise 25 bushels to an acre. Therefore the wheat must sell in the market at an average of $1.20 if such cultivation is to go on. In the same way, when third quality land producing only 20 bushels to the acre is taken up, the price of wheat will go up to $1.50 per bushel, and when fourth quality land producing, say 15 bushels to the acre is cultivated, the price of wheat must go up to $2.00 per bushel. Otherwise the cultivators of these respective qualities of land would have to allow them to go out of cultivation.

High Prices.

This, then, is a serious fact. The price of everything must needs go up as the country gets more and more crowded and worse land has continually to be brought under cultivation. Also, a larger part of the increased price goes to the landlord. For instance, when second quality land comes into cultivation, the price of wheat must, as we have seen, go to $1.20 per bushel, and the rent of 5 bushels is equal to $6.00 per acre. When third quality land comes into cultivation, the price of wheat is raised to $1.50 per bushel, and at the same time the rent on first quality land rises to 10 bushels per acre, and that on second quality land comes to be 5 bushels. Hence the rent on first quality land is now equal to $15.00 per acre, and that on second quality to $7.50. So also, when fourth quality land comes under cultivation, the price of wheat must go to $2.00 per bushel in order that its culture may be remunerative, and at the same time the rent goes up to 15 bushels or $30.00 per acre on first quality land, to 10 bushels or $20.00 per acre on second quality, and to 5 bushels or $10.00 on third quality land.

Altogether this is a very gloomy prospect for the future of humanity—continuously increasing prices once the great new areas are taken up, the landlords drawing an ever-increasing tribute from those who actually cultivate the soil.

Intensive Cultivation. Law of Diminishing Returns.

But some one will say "Why not escape this by applying more cultivation to the first quality land—intensive cultivation as it is called now?" Up to a certain limit this is quite possible, but everyone knows that if we put a second "dose" (say an extra $30 worth per acre) of capital and labour into our first quality land, it will not yield us an additional 30 bushels of wheat. Doubling the cultivation does not double the crop, and even if it did we could not go further and say that trebling or quadrupling the investment of capital and labour on an acre of ground would treble or quadruple the crop. Everybody knows they will not, probably because the crop is as much a product of the sunshine and the rain as it is a product of human effort, and we cannot double or treble the supply of sunshine and rain at will when we double the capital and labour. The natural productive forces are not doubled when the human forces of labour and capital are doubled, and therefore we cannot anticipate a doubled product. This is a general law known as the law of diminishing returns and applying to all production, but especially noticeable in agriculture and other so-called primary industries, where—so to speak—nature works along with man. Marshall defines it thus: "An increase in the capital and labour applied in the cultivation of land causes in general a less than proportionate increase in the amount of produce raised."

It is impossible, therefore, to escape by intensive cultivation from the inevitable accruing of rent. The pressure or rent, however, may be lessened and the law of diminishing returns to some extent neutralized by improvements in the art of agriculture, which may enable us to raise a larger yield from each acre of cultivated ground at the same investment of capital and labour. This larger yield enables the population, which we will say has had to resort to third quality land in order to live, to maintain itself on the products of first and second quality land alone. Thus third quality land goes out of cultivation altogether, second quality land becomes non-rentable—a drug on the market—and the rent on first quality land falls from ten to five bushels per acre. (Always think of economic rent as applied to agriculture in terms of the amount of produce and not in terms of the value of that product.)

The Neutralizing Effect of Improvements.

Of course as a general thing we do not see sudden changes of this kind. The benefits of an agricultural invention are usually only very gradually diffused throughout society and while this diffusion is going on the population is gradually increasing, the demand for food products of course increases with it, and we have these two forces neutralizing each other. But wherever an increasing population has to be fed from the food products of a country which is already settled, we will find that to secure the additional food products required, poorer and poorer land has to be placed under cultivation, and rents are thereby increased because of the greater difference in productivity between the best or better lands and the worst land under cultivation, and the final result is higher prices, since the producer on the worst land under cultivation must get enough money for his product to enable him to go on producing. If England were forced to produce food for her population, prices there would be enormous. From one point of view we may describe all history—economic history, at least—as a struggle between the law of diminishing returns and the resourcefulness of human invention. So far, the victory has lain with the latter, but no man can speak for the future.

Rent the Effect Not the Cause of Price.

There is an important corollary from the doctrine of rent, which we must now discuss. Briefly stated, it is this: Rent is the effect and not the cause of price. Let us consider this statement a little. At first it sounds rather ridiculous, but let us apply it to our imaginary community at a time when there are three qualities of land in use—30 bushel, 25 bushel and 20 bushel land—and when the price of wheat is $1.50 a bushel. Suppose that the landlords say that they will give up their rent or suppose that they are forbidden by the Government to collect it. What happens? Simply this—the farmer on third quality land continues to get his $30 for his 20 bushels per acre—just enough to remunerate him; the farmer on second quality land still sells his wheat at $1.50 a bushel—it is an old maxim that there cannot be two prices for the same commodity in the same market at the same time—and thus he gets $37.50 for his 25 bushels; the extra $7.50 which he gets more than the farmer on the third quality land, he no longer gives to his landlord but keeps for himself, and the farmer on the first quality land does likewise, though his extra gain is larger—$15.00 per acre. The consumers of wheat products are not advantaged at all; they pay just as much as before. The only change is that the rent has been transferred from the pockets of the landlords to those of the cultivating farmers. "Rent is not the cause but the effect of price," and prices are no lower when rent is taken away from the landlord than when it is paid to him. In any case it must exist, whether it fills private or public coffers.

Rent of Situation.

Rent, even on farms, depends on situation as well as on fertility. The effect of situation on the rent, is decided by the cost of transporting a unit quantity of wheat from the farm where it is grown to the market. For instance, as we have already shown, if we have first quality land—or 30 bushel land—at such a distance from the market that it takes the price of 5 bushels of wheat to bring it there, a man might just as well settle on land that is second quality in fertility—25 bushel land—if it is near the market. His net product is the same in either event. In a country like our North-West, he will probably choose the land whose disadvantages are of situation rather than of fertility, because such a disadvantage may be partially removed by the advent of new railroads, good roads, etc., while the other disadvantage is usually considered irremediable unless at great expense for fertilizer or drainage.

Urban Rent a Matter of Situation.

Situation, then, is an important factor in deciding economic rent, even in farms. It is practically the only important factor in urban rents. It makes absolutely no difference in the rent of land in the financial or business sections of any of our large cities whether that land is first quality agricultural land or solid rock. What does matter is its location. For a business firm, a site where many possible customers are passing and repassing is an absolute necessity for the success of their business. Such sites are neither cheap nor plentiful, but they must be had, and the firm pays rent, let us say, for such a location. Then with every increase in the population of the city there is usually a larger number of people passing the above-mentioned place of business, and the probability is that the rent—the "ground rent," as it is called in England—paid by the store-keepers will be proportionately increased, inasmuch as the value of the site has increased with the increasing number of passers-by who are possible customers. Urban site rents will thus increase as long as the population and wealth of the particular community continues to increase, and no longer.*

Residential sites in growing cities are, of course, subject to the same general conditions, but their value does not usually increase in the same proportion. The desirable points about a residential city lot are its nearness to the business section, its remoteness from factories (if it is likely to be occupied by anyone but workmen), the view from it, the character of the surrounding houses, etc. Its rent value will be decided by these considerations and in a growing city will show a tendency towards increase, because pleasant and convenient sites for homes are comparatively few, as compared with the increasing numbers of people who want them. Other things being equal, every additional inhabitant in a city means an increase in the land values of that city. Every loss of an inhabitant means a decline in land values. It is no wonder then that people who are interested in real estate are continually trying to induce new firms to locate in their city or town; such a proceeding has a strong tendency to increase the value of their real estate.

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*This is a general statement. Everybody knows particular cases in which the value of a business or residential site, even in the most rapidly growing urban communities, declines for some special reason, such as the presence of undesirable people in a district which has been a choice residential neighborhood.

Land Values an Unearned Increment.

Land values, then, are not at all due to any action of the individuals, though some people might perhaps call the foresight and judgment which the individual exercises in the purchase of property, his labour. If so, it is certainly a very different type of labour from what we ordinarily have, and the wages which some fortunate persons receive from it are enormous. The landlords in rapidly-growing communities are like the lilies of the field, "They toil not, neither do they spin," and yet they gather in the dollars.

Expropriation of Land Values.

The facts that landlords in rapidly-growing communities appear to make their money so easily, and that the rental value, especially in the case of urban lands, usually increases proportionately with the population, have led various writers to assert that these land values—the so-called unearned increment—are created rather by the community than by the individual, and should be appropriated by the community, or at least subjected to heavy taxation, and the amounts realized from such taxation should, according to these economists, be used to provide public services for the rapidly growing populations of such new communities. Thus, in a new district of a city, the land values, when expropriated, could be made to supply the inrush of people with streets, light, water and sewers. The more rapidly the population grew, the faster would land values increase and provide the necessary public services.

Future Land Values.—The English Plan.

The greatest name among the writers holding this view is that of John Stuart Mill, who, in his "Principles of Political Economy," advocated that a valuation should be made of all the land of a country, and all future increment of land value should be subject to specially heavy taxation. Thus existing interests would be protected, while the state would in the course of time derive a very considerable revenue from the unearned increment in the value of land. The Asquith Government in Great Britain actually carried out this scheme by providing for the valuation of all the land in the kingdom and for a tax of 20 per cent. of any increase in value that took place after the time of the valuation. Though the revenue from this tax has necessarily been almost a negligible quantity during the few years of its existence, it will probably be a source of considerable revenue, as land values increase, in the course of a generation.

Unfairness of Confiscating Existing Land Values.

Mill objected to discrimination against land-owners in the taxation of existing land values. In his opinion they had acquired their property by just as good a title as any other body of property-owners—by purchasing land with their savings or by inheriting it from their ancestors who had so purchased it, when they might have invested their savings otherwise. Now, as land-values, apart from investments sunk in the land, are simply the capitalized value of the present or prospective economic rent, to appropriate that rent-charge is to confiscate the land-owner's capital, and, while the State has power to do such things, it has no moral right to do them.

The expropriation of existing land-rents, without due compensation to the land-owners, would deal a crushing blow at the whole institution of private property. It would discourage all saving for investment, because no one would feel that his investments were safe. If the State expropriated the property of the land-owners, it might just as well go further and repudiate the national debt, take over the banks and seize their deposits, and, without compensation to the shareholders, declare the railways public property. In such a country, no one would care to save money, since he might as well enjoy it while he had it as invest it in an enterprise likely to be swallowed up by the Government. No one would be able to borrow money from abroad, for who would lend when their loans might at any time be confiscated by the Government of the debtor State? Such a condition of affairs would in the end be ruinous to the new debtor countries like our own, since it would be impossible to secure the necessary capital for development purposes, either from foreigners or from our own people, neither of whom would care to invest their capital with us. Even the latter would much prefer to put their capital somewhere else. These are the arguments usually advanced against the demands of the more rabid school of single-taxers, who advocate the confiscation of economic rent by the State, which involves the annihilation of existing land values now held as private property.

Land Originally Belongs to the State.

The scheme of the single-taxer in its most radical form involves confiscation of all existing land values through the confiscation of economic rent, upon the principle that the rental value of land justly belongs to the community, not to the individual. In the beginning this was no doubt true. In Canada, for instance, the original title to all the land rested in the Crown—that is, the people—and the people were under no obligation to grant lands in perpetuity to anybody. Indeed the greater part of the soil of Canada still belongs to the community, and no essential injustice will be done to any individual if the community declines to grant any more of that land in full ownership to individuals. So far, however, is the community from doing this, that it declares itself ready to grant to any man who will settle on Western farms and perform certain not very onerous duties of cultivation, 160 acres of land in perpetuity. Apparently, then, even from the community's point of view, the best way to increase the national wealth is to grant to bona-fide agriculturists on easy terms land on which they may carry on cultivation; especially as the land is worth very little to the community until it is cultivated.

The State thus makes a sort of contract with a man that it will grant him land in perpetuity if he will go ahead and cultivate the land, which is worth practically nothing to the State until it is cultivated. Then, after he has performed his share of the contract the State comes and takes the unearned increment, which has been usually considered as a bonus justly due to the settler on account of the hardships which he suffered in going in and beginning cultivation. Thus the State practically breaks its contract.

Thus, too, when the State opens up a new town-site like those along the line of the Temiskaming and Northern Ontario Railway, it sells the lots with all their possibilities of unearned increment to the highest bidder. Sometimes the purchaser loses on his investment; more often, probably, he gains, as he certainly has done in the past few years of exceptional development, which, however, may not continue. It is not fair or just for the State to sell a man lots in this way and then deprive him of any possible gain by discriminatory taxation. The State has no more right to be unjust than has an individual, though a sovereign State may have the **power** to be so; just as several American commonwealths were able to repudiate their debts. Their dishonesty did not in the long run profit them in the one case; it is not likely to turn to the State's advantage in the other.

Expropriation of Rent Means Confiscation.

The immediate appropriation of all existing economic rent by the State would mean the confiscation of the whole or of a considerable part of the property of landlords, imposing an entirely inequitable burden upon present owners, and no burden at all upon future owners, since, when property was sold, they would calculate the capitalized value of the extra tax upon it, and deduct that amount from the purchase price. This may be illustrated by an example:

Suppose I purchase for $1000 an urban lot, for the use of which a tenant pays me $80 per year, of which $20 go for taxes. Thus my net income from the lot is $60 per year, or 6 per cent. on my investment. If, however, the State or the municipality doubles the taxation on land, I will have to pay $40 in taxes instead of $20, while my tenant wil pay me no more than before. Then, if money is worth 6 per cent. per annum, the selling value of my lot will fall to $666 2/3—the capitalized value of a net income of $40. But the State may go still further and take the whole $80 per annum of economic rent, thus leaving me no income at all. Consequently, no one will be willing to give me anything whatever for my lot, so that I have lost my $1000. And I, the present owner, would be the only one to lose, for the Government could not reach the former owner, who sold me the land for $1000, some part of which was probably unearned increment. Again, the Government could not reach the future owner, who would not pay for the lot one cent more than the capitalized value of its net earning power after the expropriation of the economic rent. In the case under discussion, this would be just nothing at all.

The Single Tax.

In Henry George's remarkable book, "Progress and Poverty," he says that it is not necessary to confiscate the land; it is only necessary to confiscate rent. This indeed amounts to precisely the same thing, since the value of any piece of land (apart from improvements) is merely the capitalized value of the present or prospective economic rent, and would at once vanish if that rent ceased. As Henry George said, "We may leave to the landholders the shell (the empty name of ownership) if we take the kernel (the rent).'' This kernel he proposed to secure from the landowner through the adoption of the single-tax, taking all the economic rent for the State and abolishing all other taxation.

The idea of the single tax has been considerably watered down since Henry George wrote ''Progress and Poverty'' thirty years ago. According to the Single-Tax Catechism, it means ''the gradual imposition of all taxes upon the value of land, **exclusive** of improvements, thereby eventually abolishing all other taxes.'' And ''it does not mean the abolition of private property in land, but simply proposes to divert an increasing share of ground rent into the public treasury.'' The grounds for doing so are ''that the site value of land is a creation of the community,'' and that the whole burden of the tax will fall on the landholder and cannot be transferred to the tenant.

Criticism of the Single Tax.

This proposed taxation has been severely criticized from several different points of view. In the first place, it may be pointed out that it will probably be a municipal, not a provincial or national tax, as it would be quite impossible for municipal, provincial, and federal governments to come to any definite and final arrangement as to the division of the spoils. The useful provisions of our constitution, that the Province shall have the revenue accruing from direct, and the Dominion that accruing from indirect taxation, keeps them from quarrelling with each other over their respective shares. The single-taxers would leave all three authorities—local, provincial and national—to squabble about the share of land rent which ought to come to each. Between them they would probably be able to expend the whole of the economic rent, and as their functions and duties enlarged—our Dominion expenditure has quadrupled in the past sixteen years—it is very doubtful whether the economic rent would be found sufficient.

Probably our Provincial and Dominion governments had better stick to their present methods of taxation.

Single Tax in Rural Districts.

Rural municipalities, at least, have little to gain from the adoption of the single tax. The value of improvements on most farms is already roughly proportional to land values. Further, if all or nearly all the economic rent is taken in taxation, no inducement is left to the nominal owner to keep his land up to the mark or to improve it. He is thus encouraged to what the Germans call Raubbau—predatory cultivation or mining the ground. This would constitute a public danger.

Single Tax in Cities and Towns.

Urban municipalities, such as our rapidly-growing Western cities, are perhaps the most favourable fields for the adoption of the single tax. Land values have been increasing so rapidly there during the past few years that the exemption of improvements from taxation has not resulted in a slump or decline in land values in cities like Vancouver and Edmonton. Thus the land-owners there do not appear to have suffered any serious injustice through the change in the methods of taxation. It is far too soon, however, to base any final conclusions upon the experience of these Western cities, which will, sooner or later, have to pass through a period of depression such as Eastern cities have experienced. When these Western cities have, like the Eastern, seen hundreds of blocks of vacant lands thrown upon their hands for non-payment of taxes, and the values of all other lands reduced through the consequent excess of the supply over the demand for it, we shall have an opportunity of coming to a more definite conclusion as to the merits or demerits of the single tax as applied to urban municipalities.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON 11.

1.—Define clearly the term "distribution," as used in economics.

2.—What are the four shares in distribution? Define and explain the various terms used.

3.—Under what circumstances does the problem of distribution not arise at all?

4.—Show how rent commences to accrue on agricultural land.

5.—What is the law of diminishing returns? What connection has it with the theory of Rent? How may its operation be neutralized?

6.—"Rent is the effect, not the cause of price." Explain fully.

7.—On what considerations does urban rent depend? Explain fully.

8.—What is meant by the "expropriation of unearned increment"? What is the case for it?

9.—What was Mill's scheme of expropriating unearned increment, and how is it now being carried out in England?

10.—What is the Single Tax, as first proposed and afterwards modified?

11.—Criticize the doctrine of the Single Tax, with reference to the raising of national and municipal revenues.

ECONOMICS

LESSON 12

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ECONOMICS

LESSON XII.

Interest.

IN the last lesson we dealt with the great question of economic rent—that rent which every entrepreneur or captain of industry has to pay for the use of the site on which his business operations are conducted. Now we proceed to discuss the second division of the entrepreneur's product—the payment which he makes in return for the use of purchasing power which belongs to others. In order to begin or to extend his business, he secures the loan of this purchasing power, which is usually transferred to him by the lender in the form of money. In return he promises to make periodically an extra payment known as interest, in addition to returning the principal sum of the loan at some appointed time. He uses the borrowed purchasing power or money to further the process of production. It may, therefore, be known as **capital,** which we have already defined as "the product of past industry used to subserve the process of future production."

Interest is the extra payment made in return for the use of money or purchasing power, that is, the money which is paid for the use of a loan. The principal sum of this loan is being, or is supposed to be, or might possibly, at the option of the borrower, be used to further the process of production, and is thus actually or potentially **capital.**

Meaning of the Term "Interest."

The word "interest" itself, when its derivation is considered, throws some light upon our problem. It is made up of two Latin words: "inter," between, and "est," is;

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*Of course, an entrepreneur may be his own landlord or his own capitalist, or both. In that case, however, he should, in order to find his net profit, deduct from his gross profit the sums which others would be ready and willing to pay him as rent for his land or as interest on his capital.

it means, therefore, "there is between," "the space or difference between." This refers to the difference between the position of the man who lends say $100 at the beginning of a year, and his position when he receives that $100 at the end of the year. There is a general impression that the man who lends $100 for a year and receives the same amount back at the end of the year has lost thereby, and is entitled to some payment as compensation, while a borrower who pays no interest on this amount secures a corresponding gain. Usually, in business transactions at least, the borrower agrees to pay to the lender an extra amount as compensation for the lender's having had to do without the use of his purchasing power during a certain period of time. This compensation is interest, the difference between the two positions. We shall later show what scientific truth there is back of this general popular impression.

In the question of interest we are concerned with both buyers and sellers of the use of money or purchasing power. I propose to deal first with the buyers. Some people might, as history shows, save money and lend it even if they received no interest in return; no one, in the business or economic world at least, would borrow money at interest if he did not expect to be able to make a net gain of some kind for himself by the use of it.

Why the Borrower Can Pay Interest.

Suppose that an entrepreneur who is already doing a flourishing business borrows for business purposes the sum of $400, the year's savings of a salaried man who earns $2,000 a year. Now, why does he borrow that money? Clearly because he expects to be able to use it in such a way that it will replace itself with interest and pay a net gain to the borrower as well. He feels that he can use the purchasing power of the $400 which he is now borrowing, in such a way that at the end of the year he will have commodities for which the public will be ready to pay say $450. Then the borrower will be able to pay back the

$400 with interest at say 6% and will still have a net gain of $26 for himself. He may, indeed, use the $400 in a number of different ways; he may devote it to the payment of wages or the purchase of a new piece of machinery. But whatever use is made of it will be in his opinion the most reproductive one, and at the end of the year, if his calculations are correct, he will be the richer man for having had the use of the $400—he will have made a profit for himself in addition to the repayment of the loan, principal and interest.

Not all entrepreneurs, of course, succeed in investing reproductively the purchasing power which they borrow. Whether they do or not depends partly on their own skill as entrepreneurs, but partly also on the chances of fortune—whether the season is a good or a bad one, etc. Every year some entrepreneurs fail to return the principal and interest due on the money—the purchasing power—which they have borrowed. Such entrepreneurs become bankrupt, and those who have loaned their money to them to be used as capital in their enterprises may lose all or a part of their investment.

The great majority of entrepreneurs, however, are able to pay this interest on borrowed capital and still make profits for themselves. The great majority of business enterprises, especially in a young and rapidly developing country like this, are successful. The failures are comparatively few. It is this fact that makes holders of capital willing to lend it to skillful entrepreneurs at a moderate rate of interest. Entrepreneurs who are not recognized as skilful, or who have a risky enterprise to finance, must pay higher interest to compensate the lenders for the possibility of loss. There is a certain possibility of loss in all investments, of course, and the rate charged for money is closely correspondent to the risk.

Why the Lender Receives Interest.

Now we must turn around and discuss the matter from the point of view of the lender of money. Why does he receive interest for that money? Why is he not satisfied or why should he not be satisfied with the return of the money which he actually lent to the entrepreneur? The entrepreneur is able to pay interest for the use of purchasing power because he is usually able to use that purchasing power in such a way as to make a net gain for himself by the use of it. His **ability** to pay interest, however, does not make him the more **willing** to do so. He pays interest on the purchasing power which he borrows because he cannot usually get the use of money or purchasing power for nothing. Why not?

The answer to this question lies very deep down in human nature. It is simply this—that to the normal economic human being, future goods to a certain amount are less valuable than present goods to the same amount. The promise of $100 in a year from now is less valuable than the payment of $100 cash down, even though the promise of future payment is absolutely certain to be fulfilled. If one is offered the choice of $100 in cash now and $100 to be paid to one from the Canadian Treasury a year from now, there is no doubt which one would prefer. ''A bird in the hand'' may not always be ''worth two in the bush,'' but it is certainly true that a bird in the hand is always worth more than one in the bush. All things future are like the bird in the bush—more or less uncertain. Our own lives are uncertain. We cannot be certain of living out the year until the treasury note comes due. And even if we were, we should still prefer the $100 down, because if we did not, we should lose the year's use and enjoyment of those commodities which the $100 would buy for us. We should lose during the year various pleasures which that $100 would have secured for us, and we could never catch up and secure those identical pleasures again.

The Psychology of Interest.

The workman who, let us say, lends $100 of his savings on the 1st of January, 1913, foregoes the pleasure of using the purchasing power of these dollars for himself; he gives up the possible pleasure to be gained from the use of those commodities which he might have purchased with that purchasing power—say a bicycle, a phonograph—articles out of which he and his family could get a very considerable degree of pleasure. He hands that money, that purchasing power—either directly or indirectly through depositing it in a bank—to an entrepreneur who uses it in developing his business. At the end of the year, let us say, he reappears and draws his money with interest, which presumably at least means an increase of purchasing power, and uses it (assuming for the moment the prices have not changed in the meantime) precisely as he might have done a year previously. Now this man is minus a year's enjoyment of the use of those commodities, but he is receiving as compensation for this loss, additional purchasing power by which he may secure increased pleasure and more commodities in the following year. He has given up his claim to certain enjoyments and satisfactions during the year 1913; consequently he is entitled to receive greater enjoyments and satisfactions in the year 1914. If he did not, where would be the use in anyone saving?

There would be some use in doing so. A man might save for "a rainy day," or he might save and deny himself in order to prevent his family suffering after he was dead, even if there were no such thing as interest. But certainly very much less would be saved than is now the case, and the entrepreneurs would likely find their enterprises tied up for lack of capital. The average man is not any too willing to postpone his enjoyments to the future even as it is. He would be much less so if he found this postponement unaccompanied by any gain of purchasing power.

Our position, then, is this: There is a sacrifice to the lender in giving up the use of his money (his purchasing power) for a certain given period of time, and therefore he must have, in business loans at least, a reward to compensate him for his sacrifice and to induce him to make that sacrifice which it is important for our industries that he should make. Of course, a man will lend money to a friend without expecting to receive interest for the use of it. This is, however, exceptional; such a man is making a sacrifice on the altar of friendship; he is not acting from economic motives at all.

Generally speaking, then, any sane person asked to choose between a certain amount of money down and the same amount at some period in the future, would choose the former.* If, however, he were asked to choose between $100 now and say $106 a year from now, he might very well hesitate. The extra $6.00 might or might not seem to him sufficient recompense for the amount of waiting involved.

We have now noticed the two factors connected with the existence of interest: (1) that of the buyer of purchasing power—the entrepreneur; (2) that of the seller of purchasing power—the capitalist.

Market Rate of Interest.

These people are, as we have seen, in the position of buyer and seller—the buyer and the seller of purchasing power. They will higgle over the price to be paid for the use of purchasing power, just as buyers and sellers higgle in any other buying and selling transaction. This would be the case even if there were only one buyer and one seller. But, as a matter of fact, there are many buyers and very many sellers of purchasing power or capital on a money market, and the current rate of interest is decided by the higgling that takes place between all of them. It is worthy of notice, too, that on the whole the price of money—the price of capital—tends to be more uniform in different markets than the price of almost anything else. This is the case because money or purchasing power can be so easily transferred from one country to another and from one market to another.

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*Some economists dispute this, saying that a man is often ready to pay a larger sum now to secure a smaller sum in his old age. This is, no doubt, true in certain cases. Some people have such a morbid fear of dying from starvation in their old age that they would be ready to pay $1,000 now to be absolutely sure of receiving $500 at the age of seventy. Such persons are, perhaps, more numerous in older societies. Their comparative rarity in Canada is well established by the relatively small amount of money received by the Dominion Government under its old age pension scheme, even though that scheme, far from giving people less than they pay in, guarantees to give them or their heirs more.

The average person shares somewhat in this fear of being left without money, and is ready to a certain extent to sacrifice interest for the sake of having cash on hand. The ordinary man likes to have available a few dollars more than he is likely to spend. Practically all of us are prepared to put up with the loss of interest on a limited sum, rather than lock that sum up in some permanent investment and then perhaps suffer for the lack of ready cash. These special exceptions, however, in no way invalidate the general economic principle.

Pure or Net Interest, and Gross Interest.

This uniformity exists, however, only with respect to pure interest, that is, interest which is not complicated with payments for risk.* A great deal of what we usually call interest is in fact payment for risk, or payment for inconvenience due to having one's money tied up when one needs it. Most of us are satisfied to have our funds earning a very low rate of interest or even no interest at all in a bank, provided that we feel perfectly certain of being able to use them at any moment we may require them. If we want an absolutely secure investment which will give us an idea of what pure interest really is, I suppose we cannot have a better example than British consols—that is, the Perpetual Annuities of the British National debt, guaranteed by the whole credit of the British people. The price of such an annuity of £2 10s per annum is at the present time about £75 or 30 times the interest payment. In other words, the rate of interest earned is 3 1/3%. One may, perhaps, regard this as pure interest so far as England is concerned.

Pure interest in Canada is rather higher, but we have

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*Marshall calls this **net** interest, while the market rate, including payments for risk, for inconvenience of having money tied up, etc., is **gross** interest.

no such well-known standard to measure it by, as most of our Canadian Government securities are held in London. Perhaps the government bonds of the Province of Ontario, which has a very favourable financial position, enormous resources and a comparatively small debt, might be recognized as an investment where the element of risk is and is known to be practically eliminated. In January, 1913, these were advertised to yield 3.90 per cent. We may consider this rate an approximation to pure interest as we have it in Canada. There are lower yields on stocks quoted in our stock markets, but in such cases the stocks are being dealt in for speculative purposes rather than as an investment—rather for prospective advance in the selling price than for the interest yield.

If we look at the stock prices and yields of dividend paying stocks as shown in any number of a Canadian financial paper, we shall see the rates of yield going all the way up from about 4% in the case of provincial government loans to about 4½% in the case of large Eastern cities, to 5% in the case of small Western cities, 6% in the case of industrial bonds, 7% to 8% in the case of preferred industrial stocks, and as high as from 20% to 25% in the case of mining stocks where there is or is thought to be a great risk of loss through the failure of "pay dirt." All these extra returns are payments for risk and are not a part of true interest at all. It is worthy of notice that the reputation of a stock—which may be undeserved—will affect the price of its issues and therefore the yield on an investment in it.

Variations in Rate of Net Interest.

We have said that pure interest in Great Britain as measurer by the price of Consols, is about 3 1-3%. Now it has not always been so high as that. In 1897 the rate of pure interest in Great Britain was only about 2½%—it cost £112 to buy an annuity of £2 15 shillings. Why is there such a difference now? The reason may be stated briefly. Pure interest is a market price of capital, arrived at between the buyer of capital and the seller of capital. If there are many buyers and few sellers of capital, the rate of pure interest is high; if there are few buyers and many sellers, the rate of interest is low. In 1897 the supply of money for investment was greater than the demand; to-day the demand is greater than the supply.

Interest Rate and Its Influence on Saving.

It may be said that in a period like the present when the rate of pure interest is comparatively high, the sellers of capital will use every endeavour to increase their savings. The increased yield on those savings will make it worth their while to do so. It must be remembered that every dollar saved means a doing without something that they might possibly have had, and that it costs a man more and more self-sacrifice to increase his savings.

When a man who has been saving nothing out of his $2,000 salary begins to save $100 a year by reducing his expenses, he naturally sacrifices first of all those articles which out of all that he has bought during the year, have had least utility to him. When he determines to save $200 a year, he must cease to purchase articles whose utility to him was greater than that of the articles which he might have purchased with the first $100 saved. Every additional hundred that our man with the $2,000 salary saves means a greater sacrifice of his tastes, his little luxuries, his comforts. At last he may come to the point where he is ready to sacrifice the very necessities of life in order to be able to save a few extra dollars, and here it may well cost him as much hardship and sacrifice to save an additional $5 or $10 as it did to save the first $100.

Just as we all know people who sacrifice the future to the present, who save nothing at all for future needs, so we probably know people who sacrifice the present to the future, who save so strenuously for their possible future needs that their life in the present is hardly worth living. They are more rarely met with than the spendthrifts, but there are a good many of them all the same.

Now as it demands a greater sacrifice on the part of the owner to save the second hundred of his $2,000 income than the first, it will in all probability take a higher rate of interest to induce him to save it. It will take a higher rate of interest to induce him to save the third hundred than the second, and a higher rate to save the fourth hundred than the third.* If he saved $300 a year when the rate of pure interest was 3½%, he may save another hundred when the rate of pure interest goes up to 4%. The stimulus leading him to save is just so much greater. Of course, he may not invest in the 4%, but in something where there is a risk of losing and where the return is higher. Still the return in the enterprise chosen is likely to be higher when the rate of pure interest is 4% than when it is only 3%. He probably receives 1% more than he otherwise would in either case.

Denunciation of Interest.

The institution of interest has been extensively denounced of late years by many so-called social reformers, particularly by the Marxian Socialists, as involving the robbery of the wage-earners and their reduction to a state of what is known as "wage-slavery." The return paid to the shareholders in a railway or a business is, according to them, filched from the wage-earners of that railway or that business institution. They have to do the work while the shareholder sits back and takes the money which he has not earned.

Early Prohibition of Interest.

The best answer to such an argument is to be found in the history of interest. The socialists point to the prohibition of interest in early times as a ground for its abolition to-day, but they fail utterly to understand the difference of conditions which we shall now proceed to explain.

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*If you neglect his life insurance as savings, and consider it as a sort of replacement allowance for the loss of the human machine to those dependent upon him, the truth of our illustration will be more obvious. The average salaried man with a family and no saved-up capital, will take out a policy to replace his earning power in case of his death, whether he does any other saving or not. Of course, the amount he will need to take will vary with the cost of living and rate of interest obtainable on money.

The laws of Moses, the philosophy of Aristotle, the ethical teachings of the early Christian Church, all forbade or discountenanced the payment and the receipt of interest. The reason for this prohibition of interest in early societies is simply this: among a primitive agricultural people the money advanced to a borrower by a lender was not intended to be nor was it likely to be used in a reproductive way by either of them, so that the borrower made no profit in money or commodities by its use, nor did the lender lose anything special by parting with it for a time. His wants could probably be quite satisfied without it. In a simple agricultural society like that of Palestine at the time of Joshua or of England in the reign of William the Conqueror there was very little opportunity for the reproductive investment of capital; in fact there was little capital needed by the ordinary cultivator, except a yoke of oxen, a few rude tools and seed corn. If he borrowed, he did so, not to improve his land or to increase his live stock, not to earn a bigger dividend, but simply to buy corn enough to feed himself and his family until the next harvest.

Money used for such a purpose cannot be called capital at all, since we have already defined capital as "the product of past labour used to subserve the process of future production." Capital is loaned for reproductive purposes; these loans were made for unproductive consumption. There was usually a charitable motive in them, as indeed is indicated by several New Testament passages, as well as by innumerable mediaeval references. They were charitable or paternal, not economic or business loans. The borrower did not gain anything by borrowing; the lender who had money to lend, lost little by lending it, since he could not usually invest it reproductively. Loans were made, therefore, "for the love of God," and not for any economic motive whatever. If the lender were not influenced by "the love of God" he would probably not lend at all.

Interest in the Middle Ages.

In mediaeval times only the Jews and irreligious persons took interest on money loaned, and at one time excommunication was pronounced upon all Christians receiving interest from their debtors. Slowly, however, certain changes took place; indeed, almost all through this period there was some slight recognition of the right of a lender to compensation in certain cases. For instance, if a debtor promised to pay his creditor by a certain day, and disappointed him, so that the creditor was prevented from meeting his own obligations and suffered loss thereby, it was, even from the first, acknowledged that his debtor ought to compensate him for that loss. This judgment was all right, but what was to prevent the two coming to an arrangement beforehand that the loan, while purporting to be for a certain time, should really be for a longer time, and that the creditor should pretend to be injured, and should receive money from the debtors as compensation for this injury? This was continually done throughout the Middle Ages in order to avoid the Church's restrictions.

Interest Becomes Common with the Growth of Trade.

The old doctrine, that all interest was usury, and that the taking of interest on money lent was a mortal sin, lasted until the time when trade began to grow. Then we find merchants inducing persons who possessed some capital to go into a sort of silent partnership with them to share the gains and losses of their enterprises. This the Church approved, provided that the capitalists were really partners, sharing in losses as well as in gains. However, these capitalists were often more anxious to have the safe return of their capital, with a small interest, than to run the very considerable risk of loss; and in the sixteenth century we find interest thoroughly established in the countries where the Reformation prevailed, which were the chief trading countries. Later on we find even the Roman Catholic Church giving up the old doctrine, which regarded the receipt of interest as a sinful act.

Reasons for Change in Modern Times.

Why did this change take place? Why do our modern views differ so absolutely from those of the mediaevals? If we find the reason, and if it commends itself to our judgment, we shall have an answer to give to our Socialist critics, who declare that interest is simply the product of the exploitation of the poor by the rich—of the proletarian by the capitalist.

The distinction lies here: Mediaeval loans were, in the main, not for reproductive or economic purposes. They were made in order to help the poor cultivator to survive the failure of his crops, or to aid the knight to equip himself for war or a crusade. Here it is quite true that the money lent did not reproduce itself; did not help, by the use to which it was put, to discharge the loan with interest and still leave the debtor better off than before. On the contrary, it made him worse off than before, just as the small loans which salaried people and wage-earners often secure to-day in time of illness or unemployment are unproductive, often resulting in the ruin of the debtor when the exorbitant rate of interest usual to the small advertising money-lender is exacted. Perhaps in such cases it would be well even to-day that philanthropic people should subscribe a fund from which such loans could be made without interest (except for the cost of management of the fund) or at a very low rate. But such loans should be made, as the mediaeval phrase put it, ''for the love of God'' if they are made at all. They have nothing whatever to do with the business or economic loans of to-day.

Does Interest Involve Oppression?

These present-day loans are, as we have seen, made for productive purposes. They are made because the borrower, who is often very much wealthier than the lender, believes that he can afford to pay a reasonable rate of interest and still make a profit for himself. In the majority of cases he carries out his schemes successfully and pays interest to those who have advanced him capital. Who is injured by his doing so? Clearly he is not; neither are his creditors. Who is there who has any complaint to make? No one.

But, say the Socialists, the workers or proletariate suffer injustice in that they do not receive the full value of their labour. The case may be boiled down to this:

Let us suppose that we have two workers—equally good—in an agricultural community, one of whom is a thrifty and saving fellow, while the other spends all he makes. The saving man employs his spare time in trying to produce tools which will enable him to do his work more efficiently; let us say that he produces a tool that would enable either himself or his spendthrift neighbor to increase the product of their labor by 50 per cent. He uses it himself for awhile and perhaps produces a second tool of the same kind which he lends to his neighbor on condition that he receives half of the increase in the latter's product. Can the first man be justly called an oppressor of the other? They both stand to gain under the new arrangement—both the lender and the borrower. Of course, we cannot consider the lender a disinterested philanthropist. But then few men are. Neither can he be called a robber. He belongs to the great mass of men who, although they do not mean to practise any injustice, are still resolved to seek their own economic advantage in their business transactions.

Non-Economic Loans.

Many loans are even to-day made for non-productive purposes. Conspicuous examples of these are the national debts of the European powers, mainly incurred on account of wars or armaments. Here the borrower makes no economic use of the money borrowed. Why, then, does he pay interest?

The borrowing nations, which we may take as typical of all non-economic borrowers, pay interest because they have to in order to get money. All around them, in the great money markets of the world, are real economic borrowers, trying to secure capital for reproductive uses and investing that capital at the very ends of the earth where lie the new countries that can be developed most rapidly by its aid. These borrowers, in many cases already masters of potential natural resources which will be actualized by the railways or factories which they intend to build, are in a position to pay a comparatively high rate of interest without being in any danger of overstepping the mark—of paying away all their profits in interest on their loans.

Therefore the non-economic borrowers whose credit is (let us say) equally good with that of the economic borrowers, must pay equally high rates for money, and must pay these rates, like any other spendthrifts, out of their capital resources. The credit of certain nations, however, is better than that of any individual economic borrower, and accordingly they can get money at a lower rate of interest. Of course when the demand for capital is greater than the supply, the rate of interest will be higher than when the supply is greater than the demand. From this point of view, the nations of the world would be doing the greatest possible service to the economic borrowers and to the economic development of the newer countries if they would abolish armaments, pay off their national debts, and thus set free enormous masses of saved-up capital to be used for reproductive purposes. The rate of interest would naturally decline on account of the lessened demand for capital, and this fact would make possible many schemes of development which, at the present high rates of interest on capital, cannot be made to pay.

Conclusion.

From all that has been said we come to the general conclusion that, our Socialist friends to the contrary notwithstanding, the receipt and the payment of interest, in the modern world, are quite natural, inevitable and legitimate transactions. The lender suffers a certain deprivation by lending; the interest which he receives is his compensation for this deprivation. The borrower makes a gain through the use of the capital that is lent to him; it is only right that he should divide that gain with the person who has made it possible. The rate of interest is decided in the open market by the free and open competition of the buyers and sellers of capital, and by the risk of loss. No one, through the institution of interest, loses anything to which he has a natural right; millions would lose their all if it were abolished. Fortunately, there is no real danger of this coming to pass.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XII.

1. Define interest and give the derivation of the term.

2. Why can the entrepreneur afford to pay interest? Why does he do so?

3. Why does the lender of money for business purposes receive interest?

4. Compare the value to a man of a certain future commodity with that of a present commodity of the same kind.

5. Would any saving take place if interest were abolished? If so, why?

6. Distinguish pure or net interest from gross or market interest.

7. What is the probable influence on saving of a rise in the rate of interest? Of a fall?

8. Why was the receiving of interest prohibited in primitive societies? When and why did that prohibition become a dead letter?

9. Does interest to-day involve oppression of the borrower?

10. Why is interest paid on loans for non-productive purposes? Why can nations raising loans for non-productive purposes get their money more cheaply than entrepreneurs raising money for reproductive purposes?

ECONOMICS

LESSON 13

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ECONOMICS

LESSON XIII.

Wages.

THE two preceding lessons—Lessons XI and XII—have dealt with Rent and Interest—the shares of the landlord and the capitalist respectively in the product of industry; in the present lesson, Wages—the laborer's or salaried man's share—will be considered. This subject will involve us in the discussion of some very knotty and controversial problems.

Wages Usually the Largest of the Four Shares.

The importance of the subject of wages may be admitted when we consider the proportion of the product of industry which comes into the hands of the wage-earner. This we may estimate, so far at least as our manufacturing industries are concerned, by referring to the statistics of the Canadian census of 1911. According to these records, the total value of manufactured goods produced in Canada in 1910 was $1,165,975,639, while the raw materials or partly manufactured goods secured for use in further processes were worth $601,509,018. Thus the net addition made by manufacture to the value of commodities in that year was $564,466,621, and we may imagine this sum as having come into the entrepreneurs' hands in 1910 as return for the sale of their product. After providing for depreciation in plant, insurance, etc.—fairly heavy charges which I have no means of estimating—they proceed to divide the balance among the four classes—land-owners, capitalists, laborers and entrepreneurs—and, according to our statistics, $241,008,416 went in economic wages.* This constitutes about 42.6 per cent. of the total product of manufactures. So we see that there is no doubt that wages is the largest single division of the product of industry. It is, of course, distributed among by far the most numerous class of the contributors to production.

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*It is first of all to be noted that wages, from the economic point of view, include the salaries of even highly paid officials, of teachers, ministers, civil servants, superintendents, etc. Of course our figures relate exclusively to manufactures, and include the salaries of superintendents, foremen, and office staff.

Increase of Average Wages in the Past Decade.

If the total wages are divided by the number of wage-earners and salaried persons as shown by the census (515,208), it is found that the average annual money wage is $467.79, equivalent to an average wage of $9 per week. While this seems a low figure, it must be remembered that in our 515,203 wage-earners is included a very large number of unskilled laborers, women-workers and young people, apprentices, etc. In 1900, the average wage, as shown by the census, was only $333.90 per year or 6.42 per week. The increase of $2.58, or roughly 40 per cent., represents a general progress in the condition of the working class—a progress in comfort modified by the increased cost of living. The average cost of living, according to the Dominion Government statistics, increased about 15.6 per cent. between 1900 and 1910. It is evident that, even after allowing for this, the average wage-earner's or salary-earner's position in 1910 was something like 25% better than in 1900. This is a very satisfactory and interesting conclusion.

So much for the general statistics of wages. Coming down to our own experience and considering the wage-earners whom we see around us and their wages, we find that the latter vary considerably in different occupations, that the man with a trade usually receives more than the unskilled laborer, that men ordinarily receive higher wages than women, and women higher wages than young people. What are the general principles that account for these variations in the rates of wages?

Labour a Commodity.

In the first place, why does the entrepreneur pay wages? He pays wages to his laborers in return for their personal services in the work of production, whether these services are rendered in the form of manual or of mental labour. These services, which Economics bulks under the name of labour, are commodities; labour is a commodity which is sold by the laborer and bought by the entrepreneur. It is not, as some people claim, a uniform commodity; it is of many kinds and of varying qualities, some of which are useful for some purposes, others for other purposes.

Wages Decided By Higgling of the Market.

The market price of this commodity in its various qualities is decided just as the price of any other commodity is settled, by the higgling of the market, in this case the labour market—by the supply and demand, by the bargaining between the buyers and sellers of labor and by their respective keenness. Where, as in the Canadian North-West, the demand for labour is greater than the supply, wages are high; where, as in Europe, the supply of labour is often greater than the demand, wages are low. Usually supply is greater than demand in the lower unskilled sorts of labour; the opposite is ordinarily true of the highest and most specialized grades. The reason for this is probably that a good many men of the higher grades of labour are, through vice of some kind or another or through the elimination of their particular specialty by some improvement in machinery, relegated to the lower unskilled class of laborers. No doubt a great many others are at the same time rising in the industry; a great many fathers in the less skilled trades are placing their sons in the more highly skilled occupations. As civilization has progressed, man's needs have become more complicated, requiring an ever greater amount of skilled labour in order to satisfy them. The increased use of machinery has also taken away much more of the work of unskilled than of skilled men, and thus the number of unskilled laborers required in the world's work bears a decreasing proportion to the total. To give an example: if teams are in the next decade replaced by great electric trucks carrying ten times the load that a team of horses draws, will this very fact not give rise to an unemployment problem of considerable magnitude?

Labour is a Commodity of a Peculiar Kind.

Labour, then, is a commodity, but it is a commodity in one respect different from all other commodities which we know: it is inseparable from the person of the laborer. Wherever he sells his labour, there he has to go. The typical laborer of to-day goes into the factory; or, acting under his employer's orders, boards a railway train for a distant destination, and there sells to his employer services which are inseparable from his own person. It may be said, indeed, that he sells part of himself.

Labour a Perishable Commodity.

Further, his commodity is a perishable one, and he either has to sell it for what he can get for it, like a fruit merchant with over-ripe fruit on Saturday night, or lose it altogether. Every day, every hour that he loses, perishes absolutely without bringing him in anything whatever. It seems at first sight as if he ought to accept the very lowest wages rather than spend an idle hour. He does not, however, usually do this, because of its demoralizing effect on the market. In the same way a merchant will sometimes destroy goods of a certain kind rather than sell them at an excessively low price, since the latter proceeding might destroy his market for further supplies of the same goods.

Buyer of Labour Has Advantage.

Again we should note that in the higgling of buyer and seller, the buyer of labour is ordinarily at an advantage. He is usually a more intelligent man than the seller of labour; as a business man he is generally more skilled in making bargains than the seller of labour; he is economically the stronger, and can better afford to wait till the laborer comes to his terms. In the higgling of the market, the individual employer with an economic strength usually greater than that of many laborers, is much more than a match for the individual employee. Out of this state of things have risen the combinations of various laborers together in order to maintain or advance their rate of wages. Such a combination is known as a trade union. It employs officials trained in bargaining and acquainted with the state of the labour market, and has thus succeeded in securing for the worker a higher rate—some think too high—for his labour than he could have succeeded in getting for himself by his unaided, individual efforts. Its method of dealing with employers is known as collective bargaining—bargaining at one time for all the members of the union in a certain trade in a town or city. We shall have more to say about the Trade Unions in Lesson XV., which will deal with Labour Problems.

The Cost of Production of Labour.

If we were asked what factors decided the prices of other commodities, and were told that supply and demand decided them, we should hardly consider this a complete answer. We should go on to enquire what conditions lay behind supply and demand. We should come to the general conclusion that the supply of most commodities depended upon the cost of production to the last producer whose product is required at the market price. And we should say that demand depends upon the marginal utility of commodities to buyers.

Now, leaving the demand side out of consideration for the present, what corresponds to cost of production in the case of the laborer? What is the cost of producing the commodity, labour? I suppose that we should say that it is the cost of maintaining the laborer in health and in an efficient condition to perform his labour. This is not all, however. The laborer is not able to work all through his life; the cost of production must include the cost of rearing him to the age at which he can begin labour and (though this is rather a moral than a strictly economic idea) it should include his maintenance after he is past labour. When a man comes to us and asks for work, we do not, however, attempt to estimate the cost of his training to decide his wage. But, what amounts to almost the same thing, we usually pay him a sufficient wage to enable him to maintain his wife and family as well as himself.

His wage helps in rearing his children to the age of productive labour, instead of being applied against the cost of production of our laborer himself.*

Just as in ordinary consumption goods will not usually be sold under cost of production, so the wages of labour will not ordinarily fall below the cost of maintenance. In both cases there are, no doubt, a good many exceptions to the general rule; we shall consider them hereafter.

The Utility of Labour.

The wages of labour need not, however, be merely equal to the cost of its production. That is their lower limit. What is their upper limit? Surely it is the net increase in product which is due to the employment of the last or marginal laborer. If an entrepreneur has a hundred men in his factory and an additional man can add $15 a week to the net product of the industry, he may be engaged, but his wage will not exceed $15 a week, will not in all probability be so high as that. A wage-earner cannot earn more than he brings in to his employer. The upper limit of his wage is his productivity. His utility to his employer as measured by the latter, is equal to the number of dollars worth of product which he can produce in a given period of time, less the necessary charges for housing him, providing him with machinery, power, etc., and less the discount for the interval elapsing between the payment of his wages and the sale of the finished product.

Between these two limits, then—cost of production for maintenance and utility to the employer in productivity—wages fluctuate. At what point between the two limits they will be, we cannot tell. This will be decided by the relative bargaining strength of the employer and the employee. Take, for example, the man in the last paragraph whose net utility to his employer is equal to $15 per week; suppose his cost of maintenance is $10 per week. If he stands alone or is resident in a community where there is only one possible buyer for his labour, it is likely that his wage will be near the lower limit; if he is united with the other men of his craft or if there is keen competition for his services, he is likely to find his wages approach the higher limit. Of course in this reasoning we have, for the sake of clearness, neglected the important fact that one employer may be able to make a much more productive use of the energies of our laborer than another; thus the first employer may be able to offer a wage which would be ruinous to the second.

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*Compare the agitation for the fixation of a legal minimum wage, and the passage of such legislation for many Australian and some English industries.

The Bargain Theory of Wages.

Here, then, we have a statement of the accepted theory of wages—the Bargain Theory of Wages, which is based mainly upon the analogy of labour and other commodities. It involves the assumption that the price of labour is fixed, just as is the price of any other commodity, by supply and demand, supply being based upon cost of production, and demand upon the utility of the commodity to the purchaser thereof.

While this bargain theory may satisfy us, we must remember that there are many whom it will not satisfy. The Socialists do not agree with it; the early economists did not accept it. It is a new theory, whose acceptance is consequent upon the acceptance of the Austrian theory of value—that value is based upon marginal utility. Many people quite sincerely hold other views and back them up with the great names of Adam Smith and David Ricardo, as well as those of Lassalle and Marx. It is necessary for us to consider these views of the early economists, and to explain them by reference to the world in which these economists lived. Men's theories about wages have necessarily been greatly affected by what they knew of the wage-earners around them. We must begin by an account of the origin and development of the wage-earning class.

History of Wages and Wage-Earners.

In the eighteenth century, before the age of factory production began, there was no wage-earning class properly so-called. Boys served an apprenticeship to their trades usually for seven years, and then either began business for themselves with very small capital or, if they found they had not sufficient money to become masters in their respective trades, they worked for a few years as journeymen, earning wages and saving what they could in order to acquire capital to commence business for themselves. No doubt, idle and drunken journeymen often remained journeymen throughout their lives, but the fairly thrifty man who had some technical skill in his trade did not.

After the industrial revolution—the introduction of the factory system—it was found that the new machine product was far cheaper than the old hand product. Accordingly, the new product displaced the old, and the hand-workers found themselves compelled either to lower their prices to the level of the machine prices, to learn how to operate the machine, or to go out of the trade, which often involved emigration. Many slow-thinking workers adopted the first of these courses and were slowly starved into their graves as a consequence. Others, more adaptable, found other employment, often in the new manufacturing cities of England. Still others emigrated and settled in America, where they lived a more or less rough and uncouth pioneer life, but, ordinarily at least, had plenty to eat and drink.

The machinery used in the new factories was elaborate, costing far more money than the average wage-earner was likely ever to have at his disposal. Though a few workers, by displaying great technical skill and business ability induced others to entrust them with their capital and not infrequently made fortunes through its use, the great majority of wage-earners lost all hope of ever rising out of their position, of ever becoming independent of their employer. They became hereditary wage-earners—the proletariate of the Socialists—who never controlled the tools which they used in the process of production. At first they were absolutely dependent upon the employers, the owners of the machinery; wages were reduced to the minimum and young children were forced to work long hours, especially in the cotton factories, in order to eke out their parents' miserable wage. The horrible oppression which English workers endured in the first half of the nineteenth century is to be read of not only in such romances as Kingsley's Alton Locke or in the writings of sentimentalists like Ruskin (Crown of Wild Olives), or Carlyle (Past and Present), or in poems such as Mrs. Browning's "Cry of the Children." Terrible conditions are only too plainly revealed in the evidence and reports of grave Parliamentary Commissions and Committees.

Since that grievous time which followed the invention of machinery and its introduction into general use, the course of wages has been on the whole upward. In England, for instance, money wages increased 79½ per cent. between 1850 and 1910, and real wages (purchasing power of the money wages), increased 69 per cent.

It is also to be noted that wages, while increasing, must naturally bear a diminished proportion to the whole product of labour. This is necessarily the case, because the more a country gains in industrial skill and development, the larger becomes the average capital per workman. As interest on that larger capital, the man who advances it must have an increase in his share of the product. Thus in 1900 the wages and salaries of those employed in manufactures in Canada amounted to 52.7 per cent. of the total net product. In 1910 they have sunk to 42.7 per cent. While the percentage of the net product going to wage-earners has declined, the actual amount of wages has, as we have seen, greatly increased.

Early Theories of Wages.

At the time when our science of Political Economy was beginning to arise, many writers naturally turned their attention to the question of wages. They saw the wage-earning class rising up all around them. They saw these people receiving higher wages in some districts than in others and more steadily employed in some districts than in others. They speculated on the causes which fixed the rate of wages, and their speculations were naturally greatly influenced by the actual conditions which they saw around them. Generally speaking, the earlier theories of wages were more pessimistic than the later theories, since the position of the working class was then much worse. Besides the Bargain Theory, three chief theories of wages have been propounded, all of which it is necessary for us to discuss, because, although some of them have been more or less discredited by experience, they still retain an enormous influence over the minds of millions of people. As they form the basis of great popular movements, it is necessary for us to understand them.

The Subsistence Theory of Wages.

The first of these great theories which have so influenced nineteenth and twentieth century thought, was first advanced shortly before the French Revolution by Turgot, a distinguished French statesman and scholar. Living among a poverty-stricken nation of serfs, villanously overtaxed by both church and state, Turgot naturally came to the following conclusion: "In every sort of occupation it must come to pass, and in fact it does come to pass, that the wages of the artisan are limited to that which is necessary to procure him a subsistence. . . . He earns no more than his living." This was the beginning of what is generally termed "The Subsistence Theory of Wages" or "The Iron or Brazen Law of Wages." By this Turgot did not mean what we do to-day—a comfortable living—but merely enough food of poor quality to keep the wage-earner from starving to death, and enough clothes and shelter to keep him from freezing.

Adam Smith and Ricardo, living in a country where the poorer classes were more prosperous than in pre-Revolutionary France, show a tendency to a more optimistic theory than the Subsistence Theory of Wages. Yet sometimes they reverted to the more hopeless point of view, and passages from Ricardo's writings can be quoted which give the impression that he at any rate implicitly believed in the "Iron Law of Wages." Malthus, a third writer, showed that under existing conditions the workers could not earn more than a subsistence anyway. If at any time and place they did earn more, the working-classes would certainly reproduce themselves in such numbers that before long the labour market would become congested and wages would sink to the minimum amount necessary to keep soul and body together and to enable the worker to propagate his kind.

Here again we have the subsistence theory or iron law of wages expressed in the most thorough-going way. Assuming for the moment that it were true, what difference would there be between such a condition of things and slavery? There would be this difference in favour of the wage-earner that he could usually change his employer; on the other hand, the employer would have no interest in maintaining the wage-earner in good health and taking care of him. His interest would be to exploit the wage-earner to the uttermost, then throw him aside and engage another.

Is this a fair picture of modern industry? The Socialists of the German School say so; their great leaders, Karl Marx and Ferdinand Lassalle, believed in the subsistence theory of wages in its narrowest form. They said that the immense savings of time and labour effected by all the labour-saving machinery that has been invented have gone into the pockets of the capitalists (among whom they include entrepreneurs), and that the wage-earner has gained nothing at all from all the progress of the nineteenth and twentieth centuries. All the gain from all these inventions has passed into the hands of the capitalists, and the working-class is no better off than before the Industrial Revolution. This is believed almost as an article of faith by a very considerable number of people.

The facts are against this theory, and it is probably only the short memory of the average worker which makes it possible for him to accept it. There is abundance of statistics to show that in the various European nations both wages and the general conditions of life of the working-classes have greatly improved in the past fifty years—not that they are even now anything to boast of! Among ourselves statistics are admittedly very defective, but we have seen that both money wages and real wages are on the up-grade.

Meaning of the Subsistence Theory of Wages.

What is behind this Subsistence Theory of Wages, and why was it advanced? It was based on the experience of its authors, yet at the time when it was promulgated the same law of wages was in force as now. The difference was that the working classes were so ignorant and unenlightened, so disunited that they could not resist the employer, and the supply of labour was so much greater than the demand, that employers of labour were able to force down the wages to the minimum at which the workers could keep body and soul together.*

The subsistence theory of wages permits of a very curious variation known as the Standard of Comfort Theory of Wages, which amounts to about the following: if a number of men in a certain locality believe that certain comforts are to them a necessity and refuse to work at all for a smaller wage than will provide these comforts, they will very probably gradually succeed in gaining their point, provided always that the employer's profits are sufficient to allow him to pay such wages, and provided also that it is impossible for him to bring in outsiders.* It may also be said that the efficiency of his employees may be so increased by the increased wages that he will lose nothing in the long run, but this would probably not apply to all cases. But there is no doubt that in the majority of instances men work all the better for being well paid and having comfortable homes and tolerable conditions of life. Of course there are limits; a laborer's efficiency is not increased through the use of oysters and champagne.

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*The employer, in cases where he is unusually powerful or the laborer unusually ignorant, is often able to secure the labour of a whole family for practically a subsistence wage, instead of paying this amount for the labour of one man. Recent revelations show that child labour especially is ruthlessly exploited in the Pennsylvania coal mines and among the poor whites of the Southern States. This, while no doubt advantageous to the employer, is from the public point of view a ruinous proceeding, resulting in stunted bodies, ignorant minds, and depraved morals among the rising generation. Apart entirely from humanitarian considerations, it even decreases their economic efficiency and makes them less valuable from the economic point of view. Industries which cannot, as is alleged, exist without such unnaturally cheap labour, are parasitic industries, feeding upon the body politic, which would be better off if it were rid of them.

Productivity Theory of Wages.

The subsistence theory of wages was on the whole an unduly pessimistic one, and naturally took its rise in a country where wages were low. Opposed to it, we have the optimistic Productivity Theory of Wages, first advanced in a country where wages were high—in the United States. There, in the sixties and seventies of the last century, it was possible, as it still is in Canada, for the laborer who had saved up a few hundred or perhaps a thousand dollars, to go West, get free land and work for himself—to "be his own boss." A distinguished American economist, President Walker, of Princeton, said that even if the laborer did not do this, the possibility that he might at any moment do so made his wages higher. If he remained in the Eastern city, it was because, all things considered, he was doing as well there as he could do on the Western farm. Walker went so far as to say that the worker was the residual claimant in distribution—that is, that he took all that was left after interest, rent and profits had been met. He would thus get the whole product, less the amount that was paid to the landlord for the rent of the site, the sum paid to the capitalist for advancing wages instead of leaving them to be met out of the sale of the finished product (the average workman could not wait for this) and the amount paid to the entrepreneur for his organizing and managing ability—that is, Wages would absorb all that was left after Rent, Interest, Profits, all fairly fixed charges, had been deducted. According to this theory, the workman would get nearly all the advantage arising from the adoption of labour-saving machines. Indeed, the entrepreneur who was managing the industry would have no personal motive in introducing such machines at all.

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*Australia and New Zealand, where the trade unions have had a great deal to say in the government of the country, for a considerable period discouraged immigration, and constituted a sort of "Workingmen's Paradise." The "yellow peril" has, however, forced them to give up this policy.

This theory is as much too optimistic as the subsistence theory is too pessimistic. If the entrepreneur who is the manager, the responsible head of the business, the person who has to decide whether a certain machine shall be installed or not, has nothing whatever to gain from its introduction, is it likely that he will disturb the ordinary routine of his works by introducing it?

From this point of view, the productivity theory of wages looks ridiculous, but at least it has supplied us with the theory of maximum wages as the subsistence theory supplies us with the theory of minimum wages. Wages can never, under ordinary circumstances, exceed those which would be fixed by the productivity theory of wages. The other participants in production must have their adequate shares; the entrepreneur, especially, must have an interest in increasing the product. Nevertheless the productivity theory of wages is approximately true in newer countries such as our own, where owing to free land and business opportunities the workman has a decided advantage over his employer in bargaining. He is able under such circumstances to exact nearly the whole of his value to his employer. Thus it may be seen to be true that while the Subsistence Theory of Wages and the Productivity Theory of Wages may be approximately true under the conditions prevailing in certain communities, the universal theory which applies and holds good in all our modern industrial societies is the Bargain Theory of Wages.

Wages cannot permanently go below those necessary for subsistence nor above the productivity of the labour. Between these limits the amount of wages is quite variable, tending to alter with every change in the bargaining strength of employers and employees. It also tends to go up when prices go up, down when they go down, but it moves more slowly. Tradition and custom exercise some influence on rates of wages—more at least than they exercise on prices. Consequently in a period of rising prices, wages go up more slowly than prices; in a period of hard times they fall more slowly than prices. The employer, other things being equal, gains at the expense of his laborers in a period of rapid rise of prices; he loses to them at the beginning of a period of depression.

How Wage-Earners Can Increase Wages.

Assuming that this theory is correct, it is evident that wage-earners may increase wages, either by restricting the supply of wage-laborers, or increasing the public's demand for their products. The second of these courses is not usually within their control, so they proceed to restrict the supply of labour. This is done in many ways. In the more highly-skilled trades, the unions keep down to the lowest level the number of men admitted to the trade; in all trades they are inclined to look askance upon the immigration of men belonging to their own crafts. Occasionally they publish statements which tend to discourage immigrants from coming into the country. It is to the employer's interest, of course, to increase the number of laborers in these trades, to bring in immigrants, often, therefore, they publish statements giving, perhaps, an unduly favourable picture of the conditions of life of the worker in Canada. They used to bring in from countries where lower wages prevailed, laborers under contract, until the Alien Contract Labour Law, passed at the instigation of the trade unionists, prevented them from so doing.

Note.—A fourth theory of wages, less important to us than the others, because it is less heard of to-day, is the Wage-Fund theory. This is, briefly, that the average wage is determined by the proportion between the circulating capital of a country available for the payment of wages, and the number of laborers seeking employment in that country. One would find the average wage simply by dividing the capital available for payment of wages—the wage-fund—by the number of people who were to share in it. The fallacy here is that there is no such thing as a **fixed** wage-fund; capital goes into the payment of wages when that is the most profitable employment, and not otherwise. There is no such thing as a wage-fund, though the maximum amount that can possibly be paid in wages is, of course, the circulating capital of a country less the necessary living expenses of the non-wage-earning classes. Just how much of the circulating capital of a country is used for the payment of wages naturally depends what it can earn in that way as compared with what it can earn in some other way. If such employment is very lucrative, great masses of capital will, as we have seen, come in from abroad attracted by the high rates of interest.

The Wage Fund Theory is usually connected with the name of John Stuart Mill, who was its chief exponent. Mill, however, towards the end of his life repudiated the doctrine.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XIII.

1. How does the economic use of the term "wages" differ from the ordinary use of the word?

2. Give figures showing increase in average wages in various occupations in the past decade. (Supplement the statistics given in the lesson by reference to wages and salaries paid in various occupations in your locality as compared with those of ten or twelve years ago.)

3. Show that labour is a commodity, and point out the peculiarities which distinguish this commodity from other commodities.

4. Account for the rise of trade unionism by reference to the theory of wages.

5. What is meant by the "cost of production" of labour? Explain fully.

6. When and under what circumstances did the class of life-long wage-earners arise?

7. What was the first theory of wages? Under what circumstances was it advanced?

8. What use is being made of the "Subsistence" Theory of Wages to-day? Show its inaccuracy.

9. What is the "Standard of Comfort" Theory of Wages?

10. What is the "Productivity" Theory of Wages, and how did it come to be advanced? Point out the error in it.

11. What is the value for us of the Subsistence and the Productivity Theories of Wages?

12. Account for the attitude of employers and trade unions (a) towards apprenticeship, (b) towards immigration, on the basis of the Bargain Theory of Wages. Would that attitude be the same if the Subsistence Theory or the Productivity Theory of Wages were true? Explain.

ECONOMICS

LESSON 14

By

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ECONOMICS

LESSON XIV.

Profits.

IN the present lesson we have as our subject the last of the four shares in the distribution of wealth—Profits. This is the share which remains in the hands of the entrepreneur after he has compensated landlord, capitalist and laborer for the use of their land, capital and labour respectively. In dealing with this subject it is well first to consider what sort of people receive profits and what are the services which they render to society in return.

Who are entrepreneurs?

What is an entrepreneur? The word has been borrowed from the French and, literally translated, is equivalent to "undertaker"—one who undertakes the management of a business, who takes the chance of success or failure, who gains if he manages his business well and loses if he manages it ill. Besides these gains or losses due to his own ability the entrepreneur is also liable to incur losses arising from causes altogether outside of his own control, but due to the chances of business—an over-supply of his wares on the market, "tight" money which compels him to pay more than he has expected for his capital, or labour troubles which force him to pay more wages than he has calculated upon. He has, on the other hand, corresponding possibilities for gain—a market understocked with his wares, a chance to obtain "easy" money, which will enable him to make larger profits, and a supply of cheap labour.

The word "entrepreneur" has sometimes been translated "undertaker," sometimes "enterpriser," sometimes "captain of industry," though this latter translation is misleading in that it seems to imply command over numbers of wage-earners, whereas, as a matter of fact, the entrepreneur may be and often is the captain only of his own pair of hands. Anyone who is the responsible manager of a business is an entrepreneur. A limited liability corporation engaged in business is also an entrepreneur, since it carries on business and takes the risk of gain or loss.

The Entrepreneur in Agriculture.

Thus, then, our "farmer" is an entrepreneur, even though he has no hired man. Altogether apart from his manual labour, it is his business to consider the markets for his products and to sell to the greatest advantage, and it is also his business to consider the various kinds of soil at his disposal and to decide what crops can best be grown upon these different soils and what rotation of crops he will pursue. In Ontario alone there are estimated to be 175,000 farmers, and we thus have 175,000 entrepreneurs.

So too in industry. A repairing cobbler, a barber, and a Chinese laundryman are just as much entrepreneurs as is the Canadian Pacific Railway Company with its 70,000 employees or the Massey-Harris establishment. The important distinction lies not in the size of the business, but in the fact that it is a unit operating independently.

Even where the four functions—those of the landlord, capitalist, wage-earner and entrepreneur—are all performed by one person, it is possible to estimate approximately the return accruing to the individual under each of the four heads. Thus, for example, take the case of the average farmer who owns his farm and the buildings and stock thereon. The average annual product of the Ontario farm is estimated by the Ontario Department of Agriculture as being worth $2,000. Now, let us assume that this average farm is cultivated by the labour of one farmer, with the assistance of one hired man for the seven or eight months of the agricultural season. The farm land is worth, let us say, $3,000; buildings, fences, etc., $3,000; stock and implements necessary to cultivation, $2,000. Let us suppose money to be worth 6%. Our farmer's income after allowing say $300 for the hired man's board and wages will be about $1,700. This may be divided roughly as follows:

As landlord, say 6% on $3,000	$180
As capitalist, say 6% on $3,000+$2,000	300
As wage-earner* (including labour of family) say	720
As entrepreneur, say	500
Total income	$1,700

The great differences which we see in the condition of our farmers are, of course, due partly to the fact that some have much greater capital than others, but they are also due to the fact that some farmers earn practically nothing as entrepreneurs, are indeed such failures in this respect that they do not earn so much when working for themselves as they would if they worked for someone else. Other farmers are skilful entrepreneurs, and perhaps on a farm similar to that which we have described, will earn $1,000 or more instead of $500 for the entrepreneur's part of their work. The annual extra $500 is then presumably saved and added to capital, giving its owner opportunity to carry on his enterprise on a larger scale and thus increase his income. These two classes of men are popularly known as "good managers" or "bad managers."

If the ability as an entrepreneur—the business ability—of our farmers could only be increased, there is no doubt that their product could be much augmented without any additional burden of hand-labour. The difficulty is to make 175,000 farmers skilful entrepreneurs.* Business

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*The farmer's income as wage-earner is here understood to be equal to what he and his family could earn if they were working for someone else. His own value as a wage-earner might possibly be reckoned lower, say at $500.

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*As we have noted in a previous lesson, large-scale production does not obtain to any considerable extent in agriculture. There are more entrepreneurs (farmers) in agriculture than wage-earners who are not entrepreneurs (hired men). In manufactures there are many more employees than employers.

ability and business education are not common enough for us to make so large a percentage of our population good business men. However, there is no doubt that the farmer's skill as entrepreneur, and indeed the skill of business men generally, is increasing and is enabling them to obtain better results with less actual manual labour than formerly. The chief work of our model farms and our Departments of Agriculture is to make our farmers better entrepreneurs, to enable them to get better results from a given expenditure of effort.

While the entrepreneur is, in so many cases, the same person as the wage-earner, there is in the business world particularly an increasing tendency for him to be differentiated from the wage-earner. This is due to the increasing specialization of function in industry, and is inevitably the case in large scale production. Such production is to-day carried on mainly by corporations.

The Entrepreneur in Corporations.

In limited liability corporations the shareholder partakes of the functions of capitalist and entrepreneur. He resembles the former in having an investment of so many dollars in the company, the latter in being the ultimately responsible entrepreneur, though at the annual meetings he delegates the active work of managing the business to the president and board of directors and indirectly to the general manager employed by them. The shareholder, however, cannot delegate his profits and losses to someone else. He is the person to whom the gains accrue and who incurs the losses incident to the enterprise, while the bondholder who lends money to the company is the pure capitalist who gets his interest on his capital whether the shareholder gets anything or not.*

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*Of course this argument does not imply that the bondholder never incurs loss. He lends to the corporation on the security of its property and earning power. His position is like that of a mortgagee, and it is possible that his advances may exceed the value of the security, especially if this is decided by forced sale at an inopportune time. He is only relatively not absolutely secure against loss.

If we wish to find out just how much the profits of a share are as distinguished from the interest, we may compare the rate of dividend received by the shareholder and bondholder, say 7% and 5% respectively. Then the extra 2% is profits as distinguished from interest, and to this may be added that part of the increased reserve which accrues to a single share—the undivided profit, as it is called. Suppose that is 1%. Then the shareholder's net profits are 3% in what we may call a fairly good year. In a very poor year, not only may the net profits be nil, but the dividend may be "passed" altogether, and thus the shareholder will receive nothing whatever for the use of his capital, and may be said to incur a loss of 5% on his capital since as a bondholder he might have received this amount.

Profits the Residual Share in Distribution.

Profits is sometimes said to be the residual share of the product of industry. This implies that it is the last share. The other shares are, over a short period of time, at least, fairly well fixed. The entrepreneur knows how much rent he will have to pay, he knows how much interest he will need to pay for the use of his capital, he knows approximately how much he is likely to have to pay in wages, and he is able to calculate with some degree of accuracy the cost of his raw material and the selling price of his finished product. If, then, he goes into business under such circumstances, it is fairly obvious that he does so because he feels that the net product with rent, interest and wages deducted will still leave him a sufficient return for his labour in doing business and organizing the work of production. He may quite easily be wrong in his calculations. Conditions may change so that his profits may be much greater or much less than he had anticipated. Even the most skilful entrepreneur may find himself financially straitened and producing at a loss.

Why should this be the case? In production there are several varying factors whose course can be only approximately predicted. The entrepreneur must, in the case of most manufacturers, produce his goods six months or a year before they are likely to be sold. He takes a chance on the state of the market at that time and all the capital he has tied up in his manufactured goods, buildings, machinery, etc., is staked on the correctness of his judgment. Many conditions which it was quite impossible to foresee may arise. As the poet Burns expresses it:

> "The best-laid schemes of mice and men
> Gang aft agley."

The Three Elements in Profits.

Profits, as analyzed by economists, appear to consist of three constituent parts:

(a) Wages of management.
(b) Ordinary gain and loss.
(c) Monopoly gains.

Wages of Management.

The wages of management, a return for assuming the labour and burden of management. This element tends to equal the amount which the entrepreneur would get if he were employed as manager at a fixed salary. Some economists prefer to classify this under the head of wages. The entrepreneur must, in the average case, earn at least as much as an entrepreneur as he would if he were working as a wage-earner for someone else. If he did not do so, he would hardly prefer the anxiety and worry of carrying on a business where he was responsible for everything, to the more mechanical and less exacting labour of the average wage-earner. The entrepreneur must keep his business in mind all the time, he must be continually planning new economies of material and of labour. He must study his markets with an anxious eye, carefully trying to anticipate the course of events which may increase or diminish the return from the sale of his products. Since human nature is as it is, the average human being will not do all this unless he can secure a sufficient reward for his labour, though there is no doubt that some people are ready to accept even less as entrepreneurs than they might get as wage earners, both because they prefer the comparative independence of this position and because they expect that a favorable turn of the market may bring them in a prize which will more than make up for their previous privations.

Ordinary Profit and Loss.

The second element which enters into profits is the gain or loss resulting from the risks inevitable in industry. Not only is there uncertainty in undertaking a new industry, but the more or less extended period of time required for production leaves the established industry subject to the risks arising from chance or uncertain events.

The risks which the average entrepreneur in business takes in modern industry are enormous—greater than the entrepreneur recognizes—though they are no doubt mitigated when the entrepreneur plays in addition some one or more of the other three roles—is landlord, capitalist or wage-earner. Such a man may earn in some of the other capacities enough to maintain himself until fortune smiles upon his efforts as entrepreneur. The risk is also less in the case of an entrepreneur who sets to work to produce a necessity of life, than in that of one who produces a luxury for which the demand may be entirely artificial and may fall away altogether in bad times. But in every case there are risks—risks many and various which no effort of human prudence could foresee. It may be worth while to refer to some of these.

(1) In the first place, there may be distress due to a general depression of trade, owing possibly to a failure of the crops. This may so restrict the demand for the entrepreneur's goods that he may have to sell his product at cost or under cost in order to secure money enough to pay wages, interest and rent. In spite of trouble and worry, in spite of all human diligence, he may find his profits just nothing at all.

(2) Again, a sudden stringency in the money market,* due possibly to wars and rumours of wars, may cut off his supply of cheap running capital which he receives from banks, and this may compel him to close up operations altogether or to sell his products at a sacrifice in order to get money to meet his engagements.

(3) There may be a shortage or entire stoppage in the supply of raw material, as when the English cotton factories had to shut down at the time of the American Civil War, because the northern war-vessels blockaded the southern ports.

(4) There may be a falling off in the demand for his particular product, due to change in the fashions or habits of a people. This occurred some years ago in the bicycle industry.

(5) The adoption of improved and more economical methods of manufacture by large scale producers may drive the small entrepreneur to the wall. He may not have the money to introduce the new machinery, even though he may have the ability to see its advantage. Or he may have both money and ability, but not have a sufficiently large product to make the new machines pay. "The International Harvester Company," says Taussig, "has a machine whose sole work is to shape poles for wagons and harvesters. The machine cost $2,500; it saves a cent per pole; it is worth while only because poles by the hundred thousand are made every year." A former lesson dealt with the advantages of large-scale production; every advantage of large-scale production is a disadvantage for the small entrepreneur who is not able to produce on a large scale. It is only where large-scale production has shown no preponderating advantage over small-scale production, as is the case in agriculture and retail selling, that small entrepreneurs have survived in great numbers.

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*A notable instance of this occurred in the winter and spring of 1912-1913.

Monopoly Profits.

The third element in profits is known as monopoly profits, which is an acquisitive gain due to superior bargaining power resulting from monopolistic conditions. For example, monopolistic conditions may allow the charging of higher prices for products, the paying of lower prices for materials, the control of labor supply, the acquisition of special privileges from public and semi-public bodies, such as low taxation, railway rebates, etc.

If one entrepreneur has a monopoly of a certain product, or of a certain service, he will usually be able to secure a higher price than would be possible under competition. His cost of production—his material, his rent, his interest, and his wage-payments—would be in no way increased, but rather reduced through his possession of a monopoly. Consequently, both by reason of higher selling prices and lower cost of production, his profits would be greater than under competitive conditions: they would contain a monopoly element.

A good example of this profit is found in the case of street railways, which often secure an exclusive right to run cars in a certain city for so many years. Then they proceed to reckon this franchise as an asset at a figure equivalent to the capitalized value of the monopoly profits as distinguished from other profits. The judges in Michigan allowed the Detroit Street Railway to reckon its franchise at $8,000,000, and issue capital stock for that amount in excess of actual investment, which means, if we reckon profits at 5%, and if the franchise was perpetual, that the monopoly profits of this concern were $400,000 per annum.*

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*Enterprises competing for trade in a certain district, and earning fair profits often agree to merge themselves into a larger corporation in order to obtain a monopoly. In such a case the amount of stock and bonds issued by the new corporation is practically always far in excess of the combined stock of the constituent companies. The excess represents in the main the capitalized value of the prospective monopoly profits. See the list of Canadian mergers and amalgamations published in the 1913 edition of the Monetary Times Year Book.

Insurances Against Entrepreneur's Risks.

The entrepreneur's position involves many worries. He has many risks of many kinds to face. Some of them may be foreseen; others are purely fortuitous; yet either kind may ruin him. It is no wonder, then, that most entrepreneurs are willing to insure themselves in one way and another against many of the risks incident to their business. Thus, one partner may insure another's life in order to protect the firm against withdrawal of capital consequent on the other's death. So, too, entrepreneurs insure their places of business and their stock against fire.

Other kinds of insurance against loss are almost as common as the foregoing. One interesting type is the insurance against having to pay too high rates for raw material, or against receiving too low rates for finished product. The entrepreneur contracts to receive from the producer of raw material a certain quantity of his product for a certain time at a certain fixed price, regardless of what the market price may be. The producer agrees to sell that quantity at that price. Thus the entrepreneur eliminates one element of risk in the situation.

A builder wishes to construct houses to sell at $5,000, involving at present prices an expenditure of $4,500. He fears an advance in the price of materials before his contract can be completed. He can buy brick at $12 a thousand, but the trend of prices is upward, and if they advanced $3 per thousand his profit would be eliminated. Owing to a shortage of his funds, or to a shortage in the supply of brick, he cannot at once secure all he will need. Accordingly, he goes to the brickmakers and offers them $13 a thousand for a sufficient number of bricks to complete his contract. He sacrifices one-third of his profit in order to insure himself against the possibility of having to sacrifice it all.

Risks Least in New Countries.

The entrepreneur has, on the whole, a better chance of making his way and earning profits in a new country than in an old. There is in the new country freer land and greater natural resources, which contribute to a greater per capita production of wealth, and there is also a large annual addition to the population through immigration. This means to the business man an increased number of customers. Fairly competent entrepreneurs are thus able to do a good business and make money. The struggle for existence does not assume the same bitterness and intensity that are evident in older countries.

In the new countries, therefore, many entrepreneurs have become exceedingly wealthy through the difference between the cost of production and the prices which they are able to secure for their products.

Profit-Sharing.

The amount of profits earned by an entrepreneur—the difference between the total cost of production and the price which he is able to secure for his products—necessarily depends very largely upon the efficiency of his staff of wage-earners, their good-will, and the energy which they throw into their work. In dull times an entrepreneur will often continue to produce at a loss rather than close down his operations and allow his staff to be scattered abroad. He does this because he realizes that if his staff were dispersed it would take much time and trouble and expense and training before an equally efficient staff could be brought together. Clearly, then, he recognizes his staff as one of the productive assets of his business—one of the means through which he secures his profits.

The Occasional Bonus.

Since this is his feeling, it is not at all wonderful that at Christmas, or at the end of the year, an employer who has earned large profits, and who feels that his staff have worked hard for him, should decide to give them a bonus in addition to their pay, as a reward for their diligence in the past and an encouragement to similar industry in the future. He may do this partly from generosity and partly form policy, believing that his staff will be so stimulated by the bonus that they will work with even greater industry in future, and will thus more than recoup the employer for his expenditure on the bonus.

The granting of a bonus such as is given in some of our banks marks the initial step in what is known as profit-sharing. The granting of the bonus is a matter of grace on the part of the employer; the employee has no right to look forward to it, and no claim upon the employer for it. At the same time, if it goes on year after year, it will gradually become almost a fixed institution of the business, and the employees would feel aggrieved if deprived of it.

Regular Profit-Sharing.

Some employers have been willing, therefore, to regularize the situation—to guarantee to the employees, in addition to ordinary wages, some definite share of the profits, thus making the bonus no longer a matter of individual caprice, but a regular payment of an amount correspondent to the general state of their business. Many differing schemes of this kind have been adopted. A few of these are worth our attention.

One method of profit-sharing is for wages and interest on capital to be paid out at the prevailing market rates, and any surplus to be divided equally between employers and employees. (Briggs colliery in England.)

Another arrangement is that the same rate of dividend shall be paid on wages as on stock. Thus, a man earning $600 a year would, in a year when the dividends paid were 10%, secure a bonus of $60 as his share of the profits. Sometimes this bonus is paid to the worker in cash; sometimes it is invested for him in the stock of the corporation, and he becomes entitled to the same rate of interest on it as the other shareholders receive. In one or two cases this policy has resulted in the workmen securing the majority of the stock and thus becoming the masters of the establishment.

Advantages of Profit-Sharing.

Profit-sharing has, in most cases, had its advantages, both from the side of him who gives and him who takes—the employer and the employee. The employer gains through having a more devoted, a more efficient, and a more permanent staff than he could otherwise secure, since usually a share in the profits is distributed only to employees who have spent a specified time with the firm.

The employee gains through having a higher wage.* He is also a gainer through the increased industry and self-respect which the feeling of a partnership in the concern gives to him. Most employers insist on their employees speaking of the firm as "we," wisely believing that a man who speaks of his firm as "we" will do more for it than one who says "they" or "the boss." Surely, if the mere word which implies co-operation is of value to a business, the actual thing itself must be of much greater value. The psychological attitude of the wage-earner is of great value to both his employer and himself.

Defects of Profit-Sharing.

The main weakness of profit-sharing is the uncertainty of profits. The efficiency and devotion of employees has, no doubt, much to do with the earning of profits, but even these may fail to earn profits in a bad season, and where no profits are earned none can be shared. The workers will then become suspicious of the employer's good faith, and it is only too probable that the whole profit-sharing arrangement will fall to the ground.

The dominant opinion of the wage-earner to-day is that of the trade union. Now, the union dislikes profit-sharing, as tending to separate workmen from their class and bind them to the employer. It interferes with "class solidarity," interferes, the union claims, with the "manly independence of the workers'' and makes them more subservient to the employer.

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*Trade union leaders sometimes maintain that profit-sharing firms do not pay the average rate of wages, in which case, of course, no real profit-sharing takes place, so such firms are not considered profit-sharing industries.

It is only the exceptional employer who will be able, by his personal qualities, to dispel such suspicions, to gain the confidence of his employees, to make them feel that he is genuinely anxious for their welfare as well as for his own, without relapsing into that patronizing attitude which is obnoxious to the workers of to-day. Thus, while profit-sharing may be successful and productive of much good in individual cases, it can hardly be expected that it will ever become a general method of improving the condition of the great wage-earning class. Other attempts at the solution of this problem will be treated in the next lesson, which will deal with Labour Problems.

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Profit-sharing experiments in Canada have been comparatively few. An important experiment in profit-sharing is thus described in the ''Labour Gazette'' for June, 1911:

''A profit-sharing scheme in force in the establishment of Messrs. W. J. Gage & Co., manufacturing stationers and publishers, of Toronto, Ont., is stated by the firm to be not only greatly appreciated by the staff, but to be of real service to business. . . . . .

''For the purposes of profit-sharing, the staff is divided into two classes, viz.: heads of departments and employees. A block of the capital stock of the company was transferred to the president, who, in turn, allotted to each of the heads of the departments a certain amount of stock, the amount varying with the experience and length of service of the beneficiary. The transfer was made under an agreement between the president and each individual concerned, by which the first charge on the dividend declared on the stock is that of reasonable interest on the stock remaining unpaid. The remaining portion of the dividend, after paying this interest, is then applied on the purchase of the stock, together with such further sums as the beneficiary may desire to apply.

"If in any year no dividend is declared by the company, no interest shall be charged, and if in any year the dividend falls below the rate fixed for interest, the dividend shall be regarded as paying interest in full. The agreements are for a term of ten years, at the end of which time the entire stock, or such as has been fully paid for, becomes the property of the beneficiary. Should the beneficiary die or leave the service of the company, it is then the president's privilege to buy back the stock, paying for it the full amount paid in by the beneficiary.

"For the benefit of the employees who are not provided for by the above arrangement, it has been the custom of the firm for a number of years to distribute among those who have been continually in their employ for at least twelve months a percentage of the profits earned. This distribution is based on the wage or salary of each employee."

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XIV.

1. Define the functions of the entrepreneur.

2. Explain how the functions of the entrepreneur are divided in modern corporate industry.

3. From the purely economic point of view, is it wise for the farmer to spend all his time in manual labour? Explain.

4. "The entrepreneur is the residual claimant of the product of industry." Explain carefully.

5. Give instances taken from the actual business world in which profits are to be regarded as essentially:

   (a) wages of management;
   (b) the result of the success of a risky enterprise;
   (c) due to monopoly of the sale of the product.

6. A promoter buys up various street railway lines, forms a new company, which is greatly over-capitalized, and sells the stock at a gain. Is the gain profit, and if so, what kind of profit?

7. "Monopoly profits are more likely to be permanent than competitive profits." Discuss.

8. What economic advantages are likely to accrue to an employing entrepreneur from the introduction of a profit-sharing scheme? Describe different schemes in operation.

9. Are labour unions likely to look with favour upon profit-sharing? Why?

10. Do you expect that profit-sharing will become common in this country? Discuss.

ECONOMICS

LESSON 15

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ECONOMICS

LESSON XV.

Labour Problems.

IN the present lesson it will be our business to consider the relations between the entrepreneur and the wage-earner—between the men who pay wages and the men who receive them. In order to do this it is necessary to glance briefly at the history of the two classes.

As we have already seen, in some industries such as our Canadian agriculture, there is no great distinction between the classes, and then no question of the relations between them need arise. Thus labour troubles or "strikes" are not heard of on the Canadian farm, though they arise on the English farm, because on the latter the functions of wage-earner and entrepreneur are divided. The English gentleman-farmer goes around supervising the work of his laborers, and does no manual labour himself—indeed he would lose the respect of his laborers if he did.

All industries were once in the same position as Canadian agriculture, but the industrial revolution and the introduction of modern methods of production brought the former state of things to an end so far as most branches of industrial activity were concerned, and divided off the sphere of the entrepreneur from that of the wage-earner in such a way that the great majority of wage-earners were forced to abandon all hope of ever becoming anything else. The division of the classes had arisen. Naturally many of the wage-earners, having lost the hope of advancement, tried to make themselves as comfortable as possible in their present position. In order to resist the strong tendency to reduction of wages in those hand industries which had to compete against the new machine industries, they organized combinations of wage-earners, pledged not to work under a certain price. Here we have the beginning of our modern trade unions.

The Early Trade Unions.

The early trade unions came into existence at a time which was, in some respects, very inopportune—the time of the French Revolution. In the prevailing alarm they were erroneously regarded as being political rather than economic in their objects; they were thought to be aiming at the subversion of the existing institutions of England and the establishment of a republic similar to that of the French. Since this was the case, it was not to be wondered at that they encountered the violent hostility of the government. In 1799 an act was passed which, under heavy penalties, prohibited all combinations of working men for any purpose whatever. This act remained in force for twenty-five years. Trade unions contrived to exist in spite of it, but were necessarily much handicapped in their attempts to negotiate with their employers, who could always make use of the law to coerce their refractory employees. Even after it was repealed in 1824, trade unions were still liable to prosecution under the common law and were frequently prosecuted as "combinations in restraint of trade."

Thus the activities of the trade unions were restricted at a time when wages were at their lowest and food prices and taxation at their highest. The result was, perhaps, the most miserable period in the whole industrial history of England. So long as all production had been carried on under the domestic system, prices of commodities had to be sufficient to insure a living wage to the average worker; when the cheap machine product came into the market, the hand workers had to compete, and, as we have said, were practically starved out in the process.

The Resort to Political Action.

The more intelligent workers, goaded by their sufferings, threw themselves into political agitation, first for the Reform Bill of 1832, and later for the People's Charter. On the failure of the latter movement they resorted once more to purely economic action and organized in the various trades large national unions such as the Amalgamated Society of Engineers. These had their central offices in London. The conservative, law-abiding policy of these unions gradually dispelled from the minds of the public the suspicions of revolutionary designs on the part of trade unions in general. The second Reform Bill of 1867 gave the vote to the skilled workers, among whom the trade unions had at that time practically their whole membership, and the new political importance of the labour vote no doubt was a factor in securing the full legal recognition of trade unions which up to that time were quasi illegal, and had no legal protection for their funds.*

The Act of 1871 Makes Unions Legal.

The act of 1871, as completed by the legislation of 1876, embodied two principles: (1) that no act of a workman should be illegal, if when performed by anyone else the act were legal; (2) that no act of a trade union should be illegal, if when performed by an individual it were legal. Peaceful picketting was expressly permitted, but any attempt at the intimidation of workers to prevent them from working at a shop where a strike existed, was forbidden. The law held (it could not do otherwise) that the right of the strike-breaker to work was just as sacred as that of the striker to refrain from working.

A serious depression which took place about 1880 and caused great suffering showed the trade unionists of England that although they had received everything for which they asked, they had not yet attained the millennium. Accordingly a considerable number threw themselves into political agitation and organized a Labour Party whose platform included nationalization of the land, mines and minerals. This party rose into political consequence at the elections of 1906 and through its independent support of the present Liberal Government of Great Britain has exercised a very considerable influence over legislation.

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*That is, the treasurer of a trade union who absconded with the funds, could not, before 1871, be prosecuted under existing laws. The union had no legal redress, just as to-day a man cannot compel another to pay a gambling debt.

Trade Unionism in Other Countries.

As the industrial revolution and factory industry spread gradually to the other countries in Europe and to the United States and Canada, trade unions were organized in these countries also, and after conflicts with the law similar to those which occurred in Great Britain, they have succeeded in achieving a considerable though varying degree of freedom of action in all the countries of the modern industrial world. The fact of their universality, even in more despotic countries than ours, is a clear proof of the essential naturalness of their existence under present industrial conditions, and a clear proof of how impossible it is to destroy them altogether. The trade union of the present has evidently come to stay and cannot be eliminated ; some of its activities may be harmful to the body politic and may be discountenanced. Some unions founded on anti-social principles may even be entirely supressed. But the union itself is a necessity of modern industrial life.

To show the extent of the trade union movement, we may copy from the Labour Gazette, published by the Dominion Government, the figures of trade union membership in the leading industrial nations:

Great Britain	3,010,347
France	1,029,238
Germany	3,061,002
Italy	709,943
Austria-Hungary	591,443
United States	2,282,361
Total	10,684,334

In these six leading industrial countries, trade unions have thus a membership of between ten and eleven millions.

Trade Unionism in Canada.

In Canada, as elsewhere, trade unions have grown with the rise of modern manufacturing industries and modern transportation systems. While a few local trade unions in highly-skilled trades have existed for some seventy years, the trade union movement has become a great force in Canada only within the past thirty or forty years. It has grown greatly in strength during the past ten or fifteen years. This growth and the increasing importance of labour problems have been recognized by the action of the Dominion Government in 1899 in creating a sub-department of labour, which was raised in 1908 to the rank of a full department. The department publishes an annual report and issues an important monthly periodical, the Labour Gazette, besides many reports on special problems, such as the cost of living.

One of these reports, that on Labour Organization in Canada, 1912, shows the extremely rapid growth of trade unions in years of prosperity. At the end of 1911 there were 1741 local branches of trade unions with 133,132 members; at the end of 1912 there were 1883 such branches with 160,120 members. Thus a single year showed an increase of nearly 27,000 members, or more than twenty per cent.

The great majority of Canadian local trade unions are branches of international unions of their various trades, the word "international" implying that branches of the union exist in both Canada and the United States. Most of these great international unions are themselves joined in a federal union known as the American Federation of Labor. The American Federation of Labor and the constituent international unions (e.g. the International Typographical Union) hold annual conventions for the discussion of problems relating to labour—wages and hours, immigration, apprenticeship, labour legislation, etc.

Definition of "Trade Union."

The trade union, as defined by the most celebrated student of such societies, Sydney Webb, is "a continuous association of wage-earners for the purpose of maintaining or improving the conditions of their employment." It aims, then, to secure an increase in wages, or at least to prevent their reduction, to reduce the hours of labour, or at least to prevent their increase.

Collective Bargaining.

The union tries to do this mainly by what is known as "collective bargaining," i.e., bargaining for a group of men at once, putting the men on an equality with the purchaser of their labour by enabling them to put what is called a reserve price on their labour—a price below which they refuse to work. The employer formerly had a great advantage in bargaining on account of the urgent necessity of the employee for work in order to get food.* The scheme of the union is to counterbalance this advantage by guaranteeing to support the employee if he cannot find work at the reserve wage. It also prevents the employer from taking advantage of the ignorance of the employee, since the trade union officer who does the bargaining is usually a skilled bargainer, and probably knows the state of the labour market quite as well as the employer. He is under no obligation to the employer, and is thus able to meet him on equal terms.

The Reserve Fund.

How can the union support men who cannot get work at the reserve bid? Through its reserve funds, into which every member who is actually at work must pay so much weekly or monthly. The bargaining strength of any union lies very largely in its reserve fund. Without this it is likely to find itself almost as powerless as the individual worker; with this it is able to call out its men and to play a waiting game until the employer, who sees his rent and his interest bills piling up, and important orders perhaps going unfilled and customers getting impatient, finds it worth his while to come to terms with the union. On the other hand, an employer who finds himself stronger financially than the union may "lock out" his employees in order to exhaust the union funds and smash the union.

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*The hungry workman who sells his labour for half its normal market value in order to get something to eat, is in practically the same position as the buyer of eatables who has to pay extraordinary prices for food, or go without.

The Restriction of Numbers.

The employer is more likely to give way in the case of a skilled trade where the number of men engaged is limited, and where new men cannot be easily trained to take the place of the strikers. Almost every union, therefore, does what it can to restrict the number of those entering the trade by limiting the number of those learning the business.* For instance the Dominion Labour Gazette for February, 1913, gives the following clause of an agreement between the Master Plasterers and the Plasterers' Union of Montreal:

III. Apprentices.—Master plasterers who have been one year in the business will be allowed one apprentice, said apprentice to serve two years before another one is taken on. . . . All apprentices are to be bound before a notary for four years.

This union evidently realizes that an artificial limitation of supply of labour, while demand presumably remains constant, is likely to mean higher prices paid for labour.

The Alien Labour Law.

Employers, on the other hand, often complain of the scarcity of labour in the skilled trades, and try to induce mechanics from the United Kingdom and the Continent of Europe to emigrate to the United States and Canada.

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*It must be said that trade unionists are not the only people who try to restrict the number of those who enter their occupation. The learned professions in Canada have done the same thing, and the vexatious provincial regulations which prevent those who have graduated in one province from practising in another are, in the main, due to a similar spirit.

The unions, which have considerably political influence, have therefore secured the passage of an Alien Labour Law (Revised Statutes of Canada, 1906, Chap. 97), which forbids employers to make definite contracts agreeing to employ workmen coming from other countries on their arrival here. Thus, we may conclude, the number of mechanics in certain trades in the United States and Canada is less than it would have been if the Alien Labour Law did not exist, and therefore their wages are higher, demand presumably remaining constant. One must not, however, overestimate the power of these unions in restricting admission to their trades. They cannot prevent immigrant mechanics who are not under contract from entering the country. Also, while they are able to restrict the taking of apprentices in the cities where branches exist, they cannot reach out into the country towns and villages and prevent apprentices from learning the trade there. Thus, while their attitude is somewhat selfish, they have not sufficient power to make it affect very greatly the public weal.

The Union in Unskilled Trades.

In comparatively unskilled work, easily learned, such as that of a street railway motorman or conductor, the position of the union is more precarious than in the case of highly skilled trades, since the supply of labour is practically unlimited. The work can be fairly well learned in a few weeks, and so the company can easily replace strikers. Under such circumstances the union's plan is to make strike-breakers understand that their position is not "healthy" for them; at least, the union will point the finger of scorn at them. Public opinion, too, will usually favour the employee against his employer; and as public opinion is a matter of importance to a street railway company, the trade union often gains a vicarious strength in bargaining on account of the reluctance of the street car company to quarrel with the public.

Why do the bulk of the people tend to sympathize with employee against employer? Because the bulk of the people in a city are themselves employees. Their action is determined by what the Socialists call "class-consciousness"—the feeling that every gain to a member of their class is in some measure a gain to them, and every defeat their defeat. Apart, also, from any consideration of self-interest, most people tend to sympathize with "the under-dog" and the wage-earner, especially the unskilled, when engaged in a struggle with his employer, is only too likely to be "the under-dog."

In conclusion, then, trade unions of the skilled trades, through their collective bargaining and their partial control of admission to their trade, have succeeded in raising materially the wages paid in those trades. Unions in unskilled trades have had a lesser degree of success in this, since the strength of these unions lies rather in their power of appealing to the public than in a naturally strong economic position.

The Public Interest in Labour Conflicts.

In all conflicts between laborer and employer, three parties are interested—the two participants in the struggle, and last, but not least, the general public. In fact, it has been said with great truth that no matter who wins in a strike or lockout, the public loses. In some cases the loss to the public is out of all proportion to any possible gain which could come to either employers or employees. The public, therefore, might naturally be expected to feel that it had a right to be considered and consulted whenever these disputes arose, and this right it might properly enforce by legislation.

Now, there would be little use in Parliament or the Ministry peremptorily forbidding all strikes or lockouts. The Government cannot well insist that such a man must work for such an employer, or that an employer must take or keep in his service a man or men whom he does not want. Such an action would, among us, be considered an unwarrantable interference with the liberty of the subject. What then can the Government do to protect the public from loss or serious inconvenience by the interruption of any of the great public services?

Industrial Disputes Investigation Act.

The Government has made an attempt to deal with the question. Under the Industrial Disputes Act of 1907, neither employers nor employees may declare a lockout or a strike in an industry which is of great public importance, such as the railways and the coal mines. If one party has a grievance against the other, it may ask for arbitration. This will result in the appointment of a commission of three (one nominated by each party and one by the Government) to consider the complaints and draw up a programme for a settlement. This programme may be rejected by either party, and a strike or a lockout then begun; but, as a matter of fact, this occurs in a very small percentage of cases. Usually the representatives of the two sides arrive at some fairly satisfactory compromise between the views of their clients, and in so doing they are aided by the Government representative. On the whole, the Industrial Disputes Investigation Act has been a great success, and many people hope that it will speedily be extended to all industries.

Bulk of Workers Not in Trade Unions.

The number of trade unionists in Canada at the end of 1912 has been already stated at 160,000, approximately 2 per cent. of the population, and according to The Labour Gazette, about 12 per cent., or one-eighth of the total number of wage-earners. What about the rest, the people who must carry on their own bargaining about hours and payment with their employer? They get, on the whole (with some exceptions in the case of unusual workmen) less than union workmen; also, they work longer hours, and it is asserted—though this is hard to prove—that they live under poorer sanitary conditions. They are, on the whole, less educated than the unionists, and are less able to resist the employer in whose hands their fate rests.

What external protection have they against a possibly tyrannical and extortionate employer?

For a long time they had practically none. The employing class was the law-making class, and the workers, though in the majority, were ill-organized, had no journals of their own, and no means of appealing to the justice or the generosity of the upper classes. The extension of the suffrage to the laboring classes, the spread of popular education, the establishment of a working-class press have made the workers a power in the land. Public opinion is now, in very large measure, the opinion of the working class, and that public opinion has tended, as it always does, to crystallize into legislation.

The Force of Public Opinion.

The public opinion of to-day holds in a vague general sort of way that the laborer who has passed the stage of apprenticeship, in or out of unions, is oppressed if he does not get a wage sufficient to support, in some degree of comfort, himself, a wife and a family of average size; if he does not get reasonable time for rest and recreation, and if he does not have reasonably healthy conditions in the place where his work is carried on. Various people have tried to estimate what wage is needed to satisfy the first of these conditions, and one American investigator claims that $600 a year in the country, $700 a year in the smaller cities, and $800 in New York are the lowest wage which will maintain an average family in a fair degree of efficiency. As the cost of living is very similar in the two countries, one might take this estimate as applying to Canada. It should be remembered, of course, that these figures are used merely to illustrate our point and not in any dogmatic way.

Similarly, in regard to hours of labor, public opinion looks forward to the eventual adoption of the eight-hour day, and tends to look askance upon an employment which keeps its employees busy for more than ten hours per day—for example, the twelve-hour day in the United

States Steel Corporation. Especially are long hours a menace where women and children are employed.

Again, public opinion requires that the workers be provided with decent places in which to work. The working day for most men includes one-half of their waking hours, and they have a right to expect that they will not be forced to spend those hours in conditions inimical to health, dangerous or unduly unpleasant. Reasonable attention on the part of the employer to the questions of ventilation, the elimination of unnecessary dust, the prevention, in so far as that is possible, of occupational diseases,* the use of safety appliances on dangerous machinery—is coming to be recognized as the right of the employees.

The Public Interest in Labour Questions.

The public is also interested in this latter point. If men work in unsanitary shops and use unsanitary methods, their product—especially if it be food or clothes—will tend to spread disease among those into whose hands it comes. Unsanitary conditions of labor will result in an unsanitary product. Even if the workers were not enlightened or educated enough to demand decent conditions of labour for themselves, it would still be in the vital interest of the great body of the public to see that such conditions prevailed. Workers in dairies, for instance, milkers on the farms, may be satisfied to work under unsanitary conditions, but such unsanitary conditions constitute a menace to the health of the general public, and consequently the authorities are justified in demanding laws requiring better sanitation, and in enforcing those laws when made. This is done under what the Americans call the "police power" of the state.

Labour Legislation—I. Sanitation.

Labour legislation touches the worker at many point. One of the most easily comprehensible is the case of sanitary legislation referred to above. Since it is of importance that factory buildings shall be sanitary, and that machinery shall be rendered as safe as possible, the governments in almost all civilized countries have made laws providing for these things, and they attempt to enforce these laws by sending around factory inspectors.* The workers are thus, without any action of their own, protected against some of the risks of industry.

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*A law forbidding the use of a certain poisonous form of phosphorous in the manufacture of matches was passed in the United States in 1912.

Labour Legislation—II. Hours of Labor.

In legislation with regard to hours of labour, Canada and the United States are much more conservative than other English-speaking countries, such as Australia and New Zealand. Where such legislation exists in the United States, it applies mainly to the labor of women and young persons, who, according to the American Constitution, as interpreted by the Supreme Court, are in some sense wards of the state, for whom regulations may be made, while grown men are considered as needing no such protection. Still, under the "police power," State governments have fixed the hours of labour in designated employments, as in smelters, underground mines, on railroads, street railways, drug stores, bakeries, and brickyards. Hours of labour on public works are limited in a number of States and by the Federal Government. For instance, the constitution of the State of Ohio has been amended so as to make eight hours per day and forty-eight hours per week the maximum for laborers on public works in that State.

In Canada, legislation follows a similar course. There is, for instance, a law in Ontario forbidding night-work for women and children; there is a law that no child under fourteen years of age shall be employed in a factory, etc. Similar legislation exists in most, if not all, of the provinces of Canada. In the different states of Australia, the 48-hour week for factory workers is fairly well established by public opinion, even where there is no law; in New Zealand it is enforced by law.

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*If the student is eager for further information, he should apply to his Provincial Government for the last report of factory inspectors.

Labour Legislation—III. Rate of Payment.

Less interference with rate of payment takes place in Canada than in most countries. Contractors tendering for contracts to the Dominion Government must do so on the understanding that they are to pay wages at fair and reasonable rates, the minimum of which is decided by the Government itself. The minimum rates to be paid on each job are published in The Labour Gazette, so that any employee who is paid less than the "fair" rates is able to complain to the Labour Department, which will make up the deficiency out of money in its hands due to the contractor.

The British and the Australian Governments have in this, as in other labour legislation, gone far beyond us. In the United Kingdom there was passed in 1909, with the approval of all parties in Parliament, an act providing for a minimum wage in what are known as the "sweated trades." These trades employ unskilled laborers, many of them women. Owing to their ignorance of the value of their own labour, and the state of the labour market in general, they were often the victims of the greed of their employers, and worked long hours for the merest pittance. In 1909 the Minimum Wage Law alleviated this condition of affairs by stating a figure below which wages must not go.

In 1912, as a result of the English coal strike, the minimum wage system was extended to the coal miners; different rates of wages were fixed as minima for different districts on account of the different cost of living. So, too, our "fair wages" on government contracts differ widely between Atlantic and Pacific.

The State of Victoria, in the Commonwealth of Australia, and the Dominion of New Zealand have carried minimum wage legislation further than any other countries. In both these countries the minimum wage is fixed by a trade board in each industry. The rates are about what would be considered here as average wages, considering the grade of labour employed. Old employees, no longer able to earn the general minimum wage, may come before the Trade Board, which is composed of representatives appointed by the employers, the employees and the Government, and have a special minimum, proportional to their efficiency, set for them.

The Results of Minimum Wage Legislation.

All this minimum wage legislation has, up to the present time, aimed rather at standardizing current rates of wages than at fixing new and higher rates. This leads us to the conclusion that, contrary to a widespread belief among workingmen, minimum-wage legislation, if it should come, would by no means introduce an ideal scale of wages. And this conclusion is supported by the results of minimum-wage legislation in England, so far as we can at present determine. The probable consequence would be that certain workers, largely of the unorganized type, who, on account of their inexperience and their ignorance of the market, are now employed at unduly low rates, would, provided the law were enforced, receive a higher rate of wages, and that certain employers who make a part of their profit out of this sort of labour, would lose it. Such legislation, if indeed it is practicable in so individualistic a country as ours, would confer its greatest benefit when applied to the labour of women and young persons of both sexes. Unlike the adult male laborer, such persons usually know little about current rates of wages and the cost of living, and are only too likely to accept whatever wages an employer offers. They are in no position to carry on bargaining for themselves, and in such a case it does not seem to the writer that any economic principle is violated by allowing the state to fix a minimum wage in their behalf. The low wages paid to working-girls are due partly to the fact that many girls living at home do not have to support themselves on their wages. The supply of such labour makes it difficult for the girl who has to live by her work to secure a living wage. The state could mitigate the great social evils which are partly due to these conditions by enforcing the payment of a minimum living wage.

Labour Legislation—IV. Workmen's Insurance.

Workmen's insurance, as provided by law, is found in its most highly developed form in Germany. There are four classes of insurance provided: accident insurance, sickness insurance, invalidity and old age insurance, and unemployment insurance. Legislation somewhat similar to that of Germany has also been adopted in England, except in regard to accident insurance. The German system, established among a people who have always been accustomed to a Government which has watched over them in a fatherly way, and controlled their actions, has proved, on the whole, a success; it is as yet too soon to pass judgment on the English system, which exists among a people who bitterly resent any interference with their liberty of action on the part of the state.

No doubt the time will come when all these great questions of workmen's insurance will have to be considered in Canada and the United States. At present, however, our workmen are so much better off and have so much greater opportunities of getting on in the world than those of European countries, that the problem of workmen's insurance has not come into practical politics. The heavy mortality and the long list of casualties due to industrial accidents have, however, brought to the front the question of industrial accidents, and the brief space that can be given to the subject will be devoted to the question of practical interest, that of Workmen's Compensation for accidents, which is now, or has been within recent years, a subject of legislation in most of our provinces.

In past years a few workmen have insured themselves against accident with accident insurance companies; others were insured by their employers, who paid a certain percentage of their pay-roll to some employers' liability company, in return for which the company undertook to pay claims arising out of the death or injury of the workman while in the service of the employer. But most workmen were not insured at all, and when they had to sue for damages in court, the damages they received, even when they were successful, were, in many cases, hardly more than sufficient to pay the lawyer. The majority of workers had no protection against accidents not directly due to the negligence of the employer. The result was that the families of killed and injured workmen were often thrown upon the charities for support, which resulted in loss to the public and in the degradation of their own character.

Finally, someone said: "Why should not the industry bear the cost of its killed and injured workmen, just as it bears the cost of its damaged and worn-out machinery, as a part of its cost of operation? Why should it be able to throw off this cost upon the public or upon the family of the worker?"

"But in many cases," was the reply, "the accident was due to the negligence of the worker. Why should the industry be penalized for that?"

The statistics show, however, that some 70 per cent. of the accidents occurred without any negligence on the part of the person injured, and very little of the remaining 30 per cent. was due to wilful or gross misconduct, but rather to some momentary carelessness or inattention, such as we all display from time to time. In such cases, too, the slight offence of the workman was already punished by his death or by the suffering due to his injury. Why exact a further penalty from his wife and children? children?

The whole trend of opinion is to-day setting in favor

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*It has been impossible to discuss Workmen's Compensation adequately within the narrow limits of a couple of paragraphs. Students interested will find much valuable material in the Interim Report of the Ontario Workmen's Compensation Commission, published by the Ontario Government.

of making the compensation, in the cases where a workman is killed or injured in the course of his employment, a charge upon the industry in which he was engaged. Thus the family will not, in such cases, be pauperized any more than is the family of a citizen who has died soon after taking out a life insurance policy. The children will be able to get an education, and will be industrially more efficient than if compelled to leave school and resort to unskilled labor at an early age. More and more it is felt that some such provision is demanded by economic expediency no less than by social justice.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XV.

1. Under what circumstances did trade unions first come into existence? Why did they arise in some trades and not in others?

2. What was the attitude of the law toward trade unions? When and why was that attitude changed?

3. Why have modern English trade unions resorted to political methods and organized a Labour Party?

4. Write a note on the causes of the recent rapid growth of Canadian trade unionism.

5. What are the aims of the trade union? How does it try to realize those aims? How would employers naturally oppose it?

6. Compare the success of unions in the skilled trades with that of those in the less skilled occupations.

7. Show (from local cases, if possible) the interest which the public has in the prevention of strikes and lockouts. State the main principle of the Industrial Disputes Investigation Act, and comment on its working.

8. Give instances of Canadian legislation with regard to sanitation, rates of pay, and hours of labour. (Refer to the Statutes of your Province at any lawyer's office or public library.)

9. Discuss minimum wage legislation as it exists in England and Australia. Where does it seem most needed?

10. What economic principle lies behind the idea of Workmen's Compensation? What social benefits would probably accrue?

N.B.—The student who is fortunate enough to have access to a public library will be aided in answering these questions by the files of The Labour Gazette.

ECONOMICS

LESSON 16

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ECONOMICS

LESSON XVI.

Transportation Problems.

Note.—Before beginning this lesson, the student should read over carefully the latter half of Lesson IV, which deals with the development of the transportation system of Canada.

Transportation the Creation of Place-Utilities.

THE transportation of commodities, regarded from the economic point of view, is simply the creation of place-utilities—the increasing of the utility of a commodity by transporting it from a place where it has less utility to a place where it has greater utility. How do we know that a commodity has less utility in one place than in another? By a comparison of the market price of the commodity in the two communities. Generally speaking, we say that a commodity has less utility in one community than in another if its market price in the first community is less than in the second.*

This difference in the utility of a commodity in two communities may, however, exist without bringing about any transfer of that commodity from the place where its utility is less to that in which it is greater. Eggs may be selling ten cents a dozen dearer in Montreal than in Ottawa, but if the rate charged by the railway companies or the express companies for transporting them from Ottawa to Montreal be fifteen cents a dozen, no one will be likely to ship them. If, however, the rate were cut down to five cents per dozen, many people would commence to ship eggs from Ottawa to Montreal, since by so doing they would realize a gain of five cents per dozen.

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*I say ''generally speaking,'' because the criterion is not absolute. One community may be so much poorer than another that, although the utility of the commodity may be greater than in the richer community, the market price will be less.

The rule deduced from the preceding argument is, then, a very simple one: Whenever the cost of production of an article in one community plus the expense of transporting it to a second community is less than the cost of producing it in the second community, the transportation of the commodity from the first place to the second will go on. When this is no longer the case, transportation will cease.

Economy of Transportation.

There is, therefore, a presumed economy in the transportation of all commodities that are actually transported from producer to consumer. The consumer could not obtain them so cheaply if they were produced where he is, as he obtains them when produced elsewhere and brought to him. All transportation, therefore, implies an economy, a saving of trouble and expense. After payment of all the charges made for transportation (and they amount to an enormous total sum), the cost of commodities is, nevertheless, much less than consumers would have to pay if these commodities had to be produced on the spot. We may be quite sure of this point at least—that the future will see transportation of commodities going on to a greater and greater extent and additional economies realized from better and more widely extended transportation systems.

The total gross earnings of our railways (in 1912, $219,400,000, or $29 per head of population, or $145 per family of five) represent a heavy charge upon the average citizen—perhaps 1/10 or 1/8 of his total income. This charge is unseen, but it enters into the cost of every commodity that has to be brought to him by rail. According to our argument there is no real loss to him, however, as the $145, relatively large sum as it is, is less than the extra amount which he would have to pay if all the commodities which he consumes had to be produced at home. The same may be said of the earnings of our steamships, interurban electric railways and our other means of transportation.

Economy of Transportation is Increasing.

Of course it is expedient for the country that the cost of transportation should be reduced to the minimum. It has been greatly reduced during the past generation. In the United States in 1909 the average rate for carrying a ton a mile on the railroad was .763 cents. In 1870 that rate was 1.889 cents; in 1880, 1.232 cents, and in 1890, .941 cents. Canadian freight rates have been reduced in somewhat similar fashion. In Canada in 1911 the freight rate per ton per mile averaged .777 cents. Freight rates are, therefore, very much lower than they were a generation ago, and thus a great many commodities can bear the cost of transportation which could not then. During the past few years, however, there has been evident, both in this country and the United States, a slight rise in freight rates, due, no doubt, to the increased wages, etc., paid by the railways as a consequence of the rapid increase in the cost of living.

While this is the cost of railway transportation, the cost of other transportation may be estimated as follows, per ton mile:

Ordinary road—25 cents.

Macadamized road—8—12½ cents.

Steamship (United States Steel Corporation Steamships running in Upper Lakes)—.107 cents.

Here also there is a tendency to increased economy. In the case of roads, this is shown by the movement for good roads, where the cost of transportation per ton mile is only about half what it is on our ordinary roads. In the case of steamships it is evidenced by the tendency to use larger and larger vessels which can be run at a lesser proportionate cost than smaller ones. The United States Steel Corporation now uses steamers of 15,000 tons, where it formerly used 5,000 ton vessels to bring down the ore from Lake Superior.

There is, therefore, a general tendency toward greater economy in transportation and the reduction of transportation rates. The slight increases in railroad freight rates during the past few years are an apparent rather than a real exception to the rule. Since railway freight rates are increasing more slowly than general prices, the percentage of the value of goods transported which is taken by the railways is less than it was a few years ago. If, as we may quite properly do, we regard the railway rate as analogous to the miller's toll, we should say that the railway takes a lesser toll now than formerly.

The Classes of Expense in Transportation.

In every process of transportation there are at least three elements of cost to be considered:

First, the cost of the human labour employed in the process.

Second: The interest on the cost of the vehicles and animals used in the process of transportation plus the wear and tear of the vehicles, the feeding of the animals, if any, or the expense of other motive power (e.g., the coal bill in the case of steam railroads or power bill in the case of electric railroads).

Third: The interest on the sums spent for the acquiring and constructing the right of way plus the cost of maintaining the same in good condition for traffic.

Toll-Roads vs. Public Roads.

A generation ago in this country there were many toll-roads—roads maintained by private individuals or by corporations who bore the expense of making the road, and of keeping it in repair and were consequently entitled to collect toll from all those who made use of it. In such a case, the user of the road bore the above-mentioned first and second costs of transportation, and paid to the company owning the road, a toll that would go to meet the third cost and to furnish a profit.

At the present time, the toll-roads have practically ceased to exist, and the user of the roads pays now, or seems to pay only charges one and two. Has item three been thereby eliminated from the list of transportation expenses? By no means.

To-day the roads are owned by the public—the counties and the townships and the urban municipalities. In some cases these roads were acquired by purchase from the private owners; in others, the roads were constructed by the municipalities themselves. In all cases the municipalities provide more or less adequately for the upkeep of the roads. The user of the roads has, it would appear at first sight, got rid of the third item in the expense account. The farmer goes to town and the townsman drives out into the country without paying a cent for the privilege of using the roads.

We have said, however, that the public pays the cost of construction and maintenance of highways. "The public" means everybody; every taxpayer has to contribute to the maintenance of roads and bridges. Thus in 1913 a taxpayer of the city of Toronto, assessed at $10,000 would have to pay $42.08 toward the expense of the maintenance of roads and bridges, sweeping, watering, etc. Item three in our transportation account is only transferred, not eliminated, when the maintenance of roads and bridges is taken over by the public.

There is, however, no doubt that, given reasonably efficient administration, the present method of constructing and maintaining roads and bridges is better than the old. The toll-gate on roads and bridges means the existence of a toll-keeper who must be paid out of the tolls collected before any of these tolls can be applied for the improvement of the maintenance of the road. Also, if the company has had to borrow money for constructing the road, it will, in all probability, have had to pay a higher rate of interest than the municipality would have had to pay. Possibly there are disadvantages when public roads are kept up by statute labour, and when such roads are constructed in localities where the traffic is not sufficiently great to enable them to earn interest on their cost of construction.

Economic Basis of the Good Roads Movement.

In all transportation, there are, as we have seen, three items of expense: the labour, the vehicles and animals used, and the construction and upkeep of the right of way. The Good Roads Movement is based on the assumption that by an increase of item three, that is, a higher expenditure on construction, and possibly on maintenance of the right of way, we can so decrease items one and two, that the result will be a handsome net saving to the community.

The Three Classes of Expenses in Water Transportation.

Take now the case of shipping. Here it would appear to the casual observer that items one and two were practically the only ones. But this is not really so. The interest on the cost of constructing harbours and of maintaining them must in general be borne either by the ships using those harbours or by the public. The expense of charting and buoying the routes, of maintaining lighthouses, of dredging, etc., is also usually borne by the public. If canals are on the route, the interest on their original cost and the current expense of maintaining them must be met either by charging tolls on the ships using the canals or out of the public treasury.

Tendency to Toll-Free Canals.

The tendency at present seems to be in the direction of making canals toll-free, and meeting the interest on the cost of construction and the maintenance charges from public funds, as in the case of roads. Thus, the State of New York, which is at the present time engaged in enlarging the Erie Canal, at a cost of $100,000,000, has provided, by the hard and fast method of constitutional enactment, that no tolls shall ever be charged for the use of the canal. This means that the public treasury will have to go on paying $4,000,000 per annum for all time, plus the maintenance charges of the canal, and get (directly, at least) nothing for it.

"When the canal is finished," says Taussig, "it will be as if Nature had made a navigable river. Doubtless more traffic will go to and through the City of New York; the rents of landowners there will swell still further; some consumers may gain in having goods cheaper. But it is at least open to question whether the labour which built the canal will yield its full normal results to the community. The test of its having been worth while must be whether canal tolls, sufficient to pay for the labour (and waiting) involved, could be borne by the traffic. It would be desirable, obviously, to have all transportation free, and to have every commodity produced, once for all, where it could be most cheaply produced. But so long as transportation involves labour and waiting, a real advantage from exchange is got only if, at the point of consumption, the total cost can be met, including that of transportation.''*

The Doubtful Expediency of Toll-Free Canals.

One cannot but feel, then, that this remission of tolls ''queers'' our accounts—that it is impossible to tell whether the enlargement of the Erie is an economic enterprise or not. It is at least an open question. In the same way it is impossible to ascertain whether certain of our Canadian canals are economic enterprises. In some cases at least there are wide-spread suspicions that they have been undertaken rather to advantage a few and to help the Government in power to maintain its grasp on the constituencies through which they run. While a liberal margin of error should be allowed, since even the greatest experts in transportation matters make mistakes as to the profitableness or otherwise of constructing a certain line of railway or a certain canal, yet the deliberate construction of an uneconomic canal for the political advantage of the party in power, is a robbery of the public treasury. In some cases, of course, there is every prospect that a canal which will not pay immediately may yet pay ultimately, and in such cases the canal may well be built. Generally, the public should not undertake an enterprise which an expert would not advise a company to undertake under similar conditions.

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*Taussig's ''Principles of Economics.'' Vol. 2, p. 365.

Three Classes of Expense in Railway Transportation.

In railways, too, there are the three chief items to be considered: (1) labour cost; (2) wear and tear of rolling stock and interest on their cost; (3) interest on cost of construction plus cost of maintaining the line.

When railways were first introduced in England, it was assumed that the rarilway companies would simply own the roadbed, as a toll-road company its road; that any man would own cars and run trains just as he would own and run canal boats or wagons, and would pay the railway company a toll for the use of their road, so that users would pay classes one and two of expense, and the Company only the third. In practical experience, such a method of operation was soon recognized as absurd, and almost all over the world railways are now operated throughout by the companies, or in some cases by the state.

When the state owns railroads, however, it sometimes transfers their management to private companies, maintaining a control over rates in order that the benefits to the public shall not be taken away. We have an interesting example of this in our own country in the case of the National Transcontinental, whose line from Moncton to Winnipeg is public property, but is leased to the Grand Trunk Pacific for a period of fifty years from the date of its completion, during the last forty-three of which the Company engages to pay to the Government 3 per cent. per annum on the cost of construction.

Railways the Chief Means of Transportation.

"The railway," says Professor Taussig of Harvard University, "is the most important among modern industries, both as regards its effects on the economic structure at large and as regards its own special problems." The railway has been the leading element in our transportation system. It has helped to promote the geographical division of labour and large scale production. More than other kinds of transportation, it presents great and important problems for solution. Itself a corporation, created under the laws of the state, it may exercise more power than the state itself in making and unmaking communities, cities and individuals along its route.

The balance of our lesson will therefore be concerned with railway problems. We shall best understand the most fundamental of these problems if we begin by a comparison of the earning powers of railways and manufacturers, as compared with their respective capital investments.

Railways Compared with Manufactures.

The manufactures of Canada had, in 1910, a total capital investment of $1,247,583,000 and an annual product of $1,165,975,000—the annual turnover being more than 93 per cent. of the total capital investment. Thus a profit of 6 per cent. on product would pay 5 per cent. to bondholders and shareholders, and still leave something over to be added to the surplus.

The railways of Canada had, in 1912, a capital of $1,588,937,000 (debentures, $818,478,000; stock, $770,459,000). The total receipts during the year were $219,403,000—or only 13.8 per cent. of the capital investment. In order to pay the very moderate dividend of 5 per cent. on capital, whether stocks or bonds, a railroad would have to set aside about 36.2 per cent. of its gross receipts—in other words, its operating expenses could not be more than 64 per cent. of its receipts and still leave a moderate return for bondholders and shareholders. As a matter of fact, the working expenses in the year ending June 30, 1912, were 68.7 per cent. of gross receipts, so that the actual return on capital invested was only 4.32 per cent. While there is, doubtless, considerable inflation in the capital, it is extremely unlikely that the average debenture-holder or shareholder, is earning 6 per cent. on his money.

Every Third Dollar Must Go to Bond or Share Holder.

Railway rates, therefore, must considerably more than pay the actual expenses of carriage. Out of every three dollars collected by the railway, at least one dollar should go to bondholders and shareholders. It would, of course, be pleasanter for the public if it had to pay only the actual expense of carrying the goods, but railways involve enormous expenditure on construction, and for the capital necessary to such expenditure interest must, on the average, be paid. While some railway lines are unable to pay dividends to their shareholders, railway shareholders must on the whole find the rate of interest that they receive equal to that received on other investments. Otherwise, they would cease to invest in railways, and would place their capital elsewhere. New railways would cease to be constructed, and, as a result, the development of the country would be hindered.

Large Upkeep Expenditure Irrespective of Amount of Traffic.

The second great feature of railways is that large expenditures are necessary to keep the line in fair condition for traffic, to maintain stations, etc. These expenditures are necessary whether the traffic is large or small, and the greater the traffic the larger is the area over which these great maintenance charges may be distributed. Consequently the expenditure as maintenance charge is less per ton mile where the traffic is large than where it is small. Increased traffic means, therefore, possible reduction of rates or else increased returns for shareholders. The first business of the railway man, therefore, is to get all the traffic he can at charges which will pay for the actual expense of transportation and leave something over for the shareholder. But a considerable part of this traffic is of low value in proportion to bulk, and can hardly pay its mere cost of transportation, let alone contribute toward the interest on the cost of the railway.* Therefore, our railway manager collects all that he can on the higher grades of goods.

Competition of Railways with Waterways.

Now, in certain places there is keen competition for traffic between railways and waterways, and in other places between different railway companies. In the first, the railways, unless they are able to secure control of the steamship companies, have to maintain, under strictly competitive conditions, a losing fight, since the actual cost of water transportation is so much less than that of land transportation. They have, however, some advantage on their side in the greater speed with which they transfer goods—especially "express goods"—from place to place. Often, too, they succeed in eliminating serious water competition by purchasing or coming to some sort of agreement with the steamship lines.

Competition of Railways with Each Other.

In places of the second class, railways may either indulge in more or less keen competition—sometimes in "cut-throat" competition—or they may come to some arrangement as to the basis on which passenger rates and freight rates are to be charged. As a rule, however, competitive points receive "better treatment" in the matter both of freight rates and passenger service than points at which one company has a monopoly of traffic. At points where competition actually goes on, the railroads are likely to find their rates forced down until the returns do little more than cover the actual expenses involved in transportation. They leave but a small margin as their contribution toward the payment of interest to debenture-holders, and of dividends to shareholders.

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*In the year 1909, out of a total freight movement in the United States of 1,460,000,000 tons, approximately 509,000,000 tons were coal and 75,000,000 tons sand and stone; that is, 40% of the tonnage carried was made up of these two low-valued articles alone, which would bear only the mere expense of their carriage.

Discrimination Between Competitive and Monopoly Points.

There is thus a discrimination between places established, and competing points tend to grow more rapidly than places where there is no competition—a fact which has played a by no means insignificant part in deciding which towns and cities shall increase in industries and population and which shall not. This discrimination, however, is not, as a rule, arbitrarily exercised. The railroad discriminates, for the most part, not because it wants to, but because it must. The law of competition forces it to make a difference, and the existence of such a law is recognized by the public authorities set up by our Government to control the actions, rates, etc., of railways, and to see that the public get fair play. These Commissions know enough not to insist that the railway shall give the same treatment to monopoly as to competitive points. They recognize that at competitive points the railway does not make much more than operating expenses, and that the money necessary to pay its bondholders and shareholders must be secured at monopoly points.

Discrimination Between Large and Small Shippers—The Rebate System.

There are other kinds of discrimination which have been practised by the railway companies. Notable among these is the discrimination between large and small shippers. This discrimination is natural enough. Usually, when any article is sold, the purchaser can get it at a cheaper price per unit if he purchases it in a large quantity. Manufacturers find themselves compelled to make special price concessions to those who are the largest buyers of their goods. So, too, railways have made special concessions of one kind or another to their largest customers—the largest shippers—in order to secure their trade and their good-will. This was usually done, not by openly cutting the rate for large quantities, but by giving rebates

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*Express companies are, for all practical purposes, special departments of the railway companies.

—by periodically returning to certain large shippers certain percentages of the rates paid by them during a given period of time. These specially low rates were extended with more or less of favoritism, and greatly aided certain companies to become predominant in their respective fields. The Standard Oil Company was particularly successful in obtaining rebates during its early history, and was thus enabled to undersell its competitors and to secure a practical monopoly of the market.

Public Interest in Preventing Discrimination Between Large and Small Shippers.

But the public was not in the least satisfied with this state of things. It regards the railway as a corporation deriving its existence from the state—an organization whose success is possible only because the state incorporates it and transfers to it part of its sovereign rights—notably the right of expropriating private property. (Railroads are, for instance, able to make private individuals sell them their property at the market price whether they want to or not.) In return for these concessions they must make concessions. They must recognize (and indeed they are doing so more and more) that they cannot be run just as any private business—that they must consider public interest as well as private profit.

Public opinion has come more and more to this point of view. Various investigations have revealed cases of what seemed to the public startlingly unfair discrimination, especially, of course, in the now famous case of the rebates allowed the Standard Oil Company. There has been much heated discussion, and finally it has come to be a widely accepted principle, that a railway may not discriminate between large and small shippers, provided the small shipper is shipping at least a carload. Higher rates are admittedly necessary for less-than-carload shipments, as these involve a proportionately heavier expense to the railway, which may not be able to fill a car with other goods, and has to do the same amount of shunting, etc., as if the car were full.

Discrimination Between Commodities.

Even before railroads came into existence, it was generally recognized that ship freight rates should vary with the value of the article shipped. The rate on coal was lower than that on iron, the rate on iron lower than that on cotton, and so on. Consciously or unconsciously, the rate charged for transportation was at least partly decided on the principle of what the traffic would bear.

The Classification of Commodities.

When railroads came into existence they began fixing their charges in competition with the existing means of transportation, and so their rates also were subject to a rough system of classification. That system of classification has been gradually becoming more elaborate, and this tended to confusion when each railroad adopted its own rates for all commodities. It was very difficult to figure out the rate for a commodity which had to travel a long distance over different railways. Finally, the railroads in different parts of the United States came to agreements as to classification of commodities, the highest class containing the most valuable commodities and paying the highest rates per hundredweight, and the other classes paying lower freight rates, down to coal, which probably, under most classifications, pays the lowest rate. The present Canadian joint classification is composed of ten classes.

How do railways decide which commodities shall go into each class? Various principles of classification have been suggested, and many of them have been actually tried in some country or other.

The Principles of Classification of Commodities.

First, a railroad might impose a uniform rate per unit of weight per mile. This would, however, practically restrict the sale of coal, etc., to a short distance from the mine, and coal is a necessity of modern life. Hence this principle has been abandoned.

Second, a railroad might impose a uniform rate per unit of weight without regard to distance, as the postoffice does. But the commodities that the railway handles are so much heavier than those which the postoffice handles that cost of handling increases rapidly with increasing distance. So this principle is inequitable and absurd.

Third, a railway may impose a rate based on cost of service rendered. But, as Taussig has shown, it is beyond the power of man accurately to estimate what additional expense is incurred by a railway for the carriage of an additional ton weight of a certain commodity from Toronto to Montreal. The railways, however, do attempt to come to an approximate conclusion as to cost of service, and their minimum charges may be said to be fixed by that conclusion.*

Fourth, rates may be decided by value of goods. But these values are all the time varying in relation to each other, and we have learned that it is of the greatest importance that railway rates shall be comparatively stable. Those who are in business must be able to estimate what rates they will have to pay for the transportation of their raw materials and their finished product.

Fifth, freight rates may be decided by value of service rendered, that is by the difference in the utility of a commodity to its shipper and to its consignee. This, however, is a psychological abstraction. The increased utility of the commodity could be estimated only by someone who knows all about the two individuals. This principle is, therefore, impossible in practice.

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*Usually eastbound traffic costs more than westbound, other things being equal. This is because so many of the cars used by bulky western products en route to the east, have to be returned empty. Hence it may pay the railway to accept traffic for the west at very cheap rates.

The Principle Accepted by Railway Men.

Sixth, freight rates may be decided on the basis of "what the traffic will bear." This is the principle now universally accepted among railway men, and it implies that freight charges shall be fixed at the rate at which the traffic yields the highest net return to the company, and the monopoly price of transportation is decided just as the monopoly price of any other commodity or service is decided. (See Lesson VII., page 10.) This principle has the advantage of being experimental and practical. The railroad manager may fix different rates until he reaches the one which yields him the greatest net return, just as the hat manufacturer, in Lesson VII., fixed the price which would yield him the maximum of profit.

The Public's Right to Object to This Principle.

The trouble with this criterion is that it does not recognize the public interest in the game. The public, already incensed at the increasing cost of living, is keenly suspicious of all combinations of monopolistic or semi-monopolistic tendencies. In the long run, the will of the people must prevail. In railway matters, the public interest, in such countries as Canada and the United States, is protected by the appointment of commissions, such as the Interstate Commerce Commission in the United States and the Dominion Railway Commission in Canada. In this country, which has done so much for the railways—given them great subsidies in money, in land, in guarantees of bonds which enable them to borrow at lower rates—the public have an excellent claim for consideration from the management of the railway, and are able to enforce it. At the same time the railway must be able to earn reasonable profits; otherwise, capital would not be forthcoming for the building of new lines of railway, and the development of Canada, in which we are all interested, would suffer.

The Powers of the Railway Commission.

The railways of Canada are placed under the jurisdiction of the Board of Railway Commissioners for Canada.

This body is composed of six commissioners and employs a traffic expert, a number of engineers, secretaries, clerks, etc. A single section of the Railway Act (Revised Statutes of Canada, 1906, Chapter 37, Section 323), will show the wide jurisdiction of this body over the railways of the country.

"The Board may disallow any tariff or any portion thereof, which it considers to be unjust or unreasonable or contrary to any of the provisions of this Act, and may require the Company, within a prescribed time, to substitute a tariff satisfactory to the Board in lieu thereof, or may prescribe other tolls in lieu of the tolls so disallowed."

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XVI.

1. Prove that transportation usually involves an increase in the value of a commodity.
2. If transportation suddenly ceased, and the charges for transportation with it, would the cost of living be increased or diminished? Discuss.
3. Is there a movement for the improvement of transportation facilities in your locality? If so, what arguments are used by its advocates?
4. What classes of expenditure are necessary in all transportation? Discuss them.
5. Compare the toll-road system with the present-day system of road maintenance.
6. Discuss the advisability of levying tolls on traffic using the canals.
7. Compare the capital and "turn-over" of railways with those of manufacturing industries.

8. Imagine yourself in the position of a railway traffic manager and discuss the problems which he has to face.
9. Why do manufacturers usually prefer to locate their plants in towns having water transportation as well as a railway, or else having more railways than one? Discuss fully.
10. What fundamental differences between the railway business and the manufacturer's business make state control more justifiable in the first case than in the second?
11. What principles have been suggested as furnishing a basis for the fixation of railway rates? Discuss them.
12. Give a short account of the powers of the Board of Railway Commissioners for Canada. Find out from railway men, merchants, etc., just what it has done for your locality.

ECONOMICS

LESSON 17

By

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ECONOMICS

LESSON XVII.

Trust and Monopoly Problems.

N.B.—The student should, before beginning work on this lesson, read over Lesson VII, especially the part treating of the fixation of monopoly and competitive prices.

Monopoly Profits.

IN Lesson VII it has been already pointed out that monopoly prices may quite conceivably be less than competitive prices, though this probably rarely occurs in actual business. Monopoly profits, however, will never be less than competitive profits, since the only object of monopolizing the sale of a commodity is to secure the greatest total net profit from it. Monopoly profits on a given product in a given market, will be greater than competitive profits on that article in that market, and where the monopoly is in control of an enormous market, such as that of the United States, the profits which it can make are stupendous. There is, therefore, every reason why producers who are desirous of making money and who already possess or can secure the capital necessary to establish a monopoly, should do so. If they themselves have not sufficient capital to control the situation, their best scheme is to enter into a combination with other producers for the purpose, arranging perhaps the terms on which the product shall be disposed of, or the territory in which each of the producers joining the combination shall, so far as the combination is concerned, be left in exclusive and monopolistic possession of the market.

Combinations Are Formed in Hard Times.

Producers are all the more apt to enter into such agreements and combinations if they have found themselves being driven into bankruptcy by hard times and "cut-throat'' competition. When men find themselves being driven to the wall, they play for safety and an exclusive market, rather than attempt the almost hopeless task of securing a larger and more profitable trade by still keener competition. Under such circumstances, the first man who is keen enough to see the advantages of substituting combination for competition as the rule of trade, will find the people whom he approaches disposed to listen to him.

An Early Pool.

Competition was keen and profits were small in the United States in the period following the Civil War. Consequently we find here the loosest kind of combination (the pool) coming into prominence in American manufacturing industry. An instance given by Ripley is the case of the Michigan Salt Association. Competition in the salt trade had proved very destructive of the capital engaged in it, and finally about 1866 we find the salt manufacturers in Michigan agreeing to sell their product to an Association which was to dispose of it for them. Thus they would cease to compete against each other in the market and would be enabled to secure enhanced profits.

Other Varieties of Pools.

This selling Association is perhaps the most common, but not the only type of pool. Palgrave's Dictionary of Political Economy mentions four other classes with the principles on which they operate: first, division of the field, where each competitor agrees to take the traffic of a certain district and withdraws from competition elsewhere; second, division of traffic, where the competitors agree upon the percentage of the business to be handled by each concern; third, gross money pools, where they agree upon a percentage of gross receipts; fourth, net money pools, where they agree upon a percentage of the profits. These latter are the closest and require a system of joint book-keeping.

Pools Illegal Under Common Law.

These arrangements are, however, regarded by the English common law as illegal combinations—conspiracies in restraint of trade. That law holds good in England, in Canada and in the United States, except in so far as it may have been modified by Statute law—law made by regular Parliamentary or Congressional methods. English common law forms the groundwork of the English and American legal systems, and the position which the English-speaking peoples take towards industrial combinations has been profoundly modified by the fact that such organizations are conspiracies in restraint of trade and have no legal right to exist.

The Pool An Unsatisfactory Organization.

What is the consequence? It is this: a manufacturer who has entered into one of these pools and has thus incurred certain obligations to the other members of the pool, may break his contract at any moment when he finds it advantageous to do so, and he cannot be held legally accountable for so doing, since the law will not enforce an illegal contract. The other members of the pool are in the position of gamblers who cannot collect debts due them. They can receive no legal redress because the courts will not enforce contracts which are in themselves violations of the law.

The pool agreement had, therefore, its disadvantages. It was formed primarily in order to extract unusually high rates of profit from the public, and its members who were so willing to extort money from the people, were, many of them, not averse from violating their agreement with each other when they found this to be to their immediate interest. As the law would not punish the offending party, the others in the agreement were powerless. Thus they found it necessary, in many cases, to substitute some closer arrangement for the existing one. If we may judge by German experience, it is unlikely that had the agreements of the pool been enforcible by law, it would ever have developed into the trust.

The Kartel.

In Germany industrial combinations have arisen as in America, and have taken the form of pools—or Kartels as they are called in that country. Their agreements have been recognized as enforcible by the German law, though the Government keeps a strong hand over them and sees that they do not unduly overcharge the public. Thus they secure all the natural profits resulting from the very large scale on which their enterprises are operated, and from the division of labour between them, without being able to evade the supervision of the Government or their obligations to each other. The result of this is that in Germany industrial combinations have remained for the most part in the pool or Kartel stage. An important German legal decision quoted in the report of the American Industrial Commission runs as follows:

"When in a branch of industry the prices of the product fall too low and the successful conduct of the industry is endangered or made impossible, the crisis setting in as the result of such a state of affairs is detrimental, not only to individuals, but also to society as a whole: and it is therefore in the interests of the community that improperly low prices should not exist in a certain branch of industry for a long time. On the contrary, when prices are for a long time actually so low that financial ruin threatens the entrepreneurs, their combination appears to be not merely a legitimate means of self-preservation, but also a measure serving the interests of the community. The formation of syndicates and kartels of the kind here discussed is, on many sides, thought to be a means particularly suited to render great service for the adequate progress of the whole economic life of society, in so far as it prevents uneconomical working at a loss, overproduction and the catastrophes connected with it."

A Closer Combination—The Trust.

It is a debateable question whether the German method of dealing with industrial combinations has not proved more successful than the English and American system.

In the United States especially, the result of the nonenforcibility of pooling agreements has been that closer organizations have arisen, in which the manufacturer who enters the organization makes over his entire plant to a group of trustees in return for certain stock or bonds in the new company, or perhaps for a cash payment. Since these various manufacturing plants are placed in the hands of trustees, the whole concern is known as a "trust."*

Under the trust agreement it was arranged that those who held stock in the constituent companies should all transfer their shares to a few persons selected as trustees, that these trustees should hold the shares and possess the voting rights thereof, while remaining under obligation to use their powers for the benefit of those who had entrusted them with their property and to whom they must turn over all dividends and profits. Thus all the enterprises composing the trust would be irrevocably bound to it. At the same time the trustees would be bound to administer these companies for the benefit of the real owners. In the case of the Sugar Refiners, however, the courts refused to enforce this agreement on the ground that it was monopolistic and in restraint of trade, so that some new device had to be invented. The first of these Trust Agreements was that of the Standard Oil Company made in 1879.

The Sherman Act.

The famous Sherman Anti-Trust Law was passed in 1890. This act begins: "Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several States or with foreign nations, is hereby declared to be illegal."

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*A "trust" should be distinguished from a trust company whose chief business is the administration of estates of deceased persons in the interest of beneficiaries—widows, children, etc.—who are often incompetent to invest the money for themselves. Though their present functions are more varied, this is the original object of the trust company, and out of this its other functions have arisen.

New Jersey the Refuge of the Trust.

This attack on the trusts led several of them, whose great resources enabled them to secure the skill of the best lawyers, to change their form. This was rendered easier by an Act of the State of New Jersey passed in 1889.

"Be it enacted that the directors of any company incorporated under this Act, may purchase mines, manufactories or other property necessary for their business, or the stock of any company or companies owning mining, manufacturing, or producing materials, or other property necessary for their business, and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be declared and taken to be fully paid stock and not liable to any further call."

This New Jersey Act, then, enabled, for instance, the Standard Oil Company of New Jersey to purchase with its own stock and hold the stock of all the other companies controlled by the Rockefeller and allied interests and made possible a unity of administration which would otherwise have been impossible. This stage is called that of the holding company. A corporation is formed which acquires the stocks of the several combining concerns—either all or a majority—and gives its own stock therefor. Its directors become the real managers of all the constituent companies, and though the original corporations nominally retain their existence, the whole control is centred in one board of directors.*

The Holding Company Declared Illegal.

Recent decisions of the United States Supreme Court (notably those against the Standard Oil Co. and the American Tobacco Co.) have, however, been to the effect that the holding company scheme is a violation of the

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*"The power of holding the stock of another corporation," says Taussig, "never belongs to a corporation under English and American law unless given in express terms by the grant of its charter from the sovereign power. In the absence of express grant, such holding is ultra vires"—outside of its legal powers.

Sherman Anti-Trust Law and have led to the dissolution of these combinations into their component parts. This dissolution, however, while legally carried out, appears to have had little practical effect, as stock in the companies formerly composing the trust is worth more than ever. It is almost if not quite impossible to prevent men who hold a preponderating interest in a number of corporations, and thus possess a voting power proportionate to the size of their holding, from regulating the policy of the various companies which they control, so as to make these companies work into each other's hands and refrain from competition. In such a case, the companies guided by one man or by a group of associates, will, whatever may be the strict law of the case, be operated as one.

The Measures Proposed to Defeat the Trusts.

A bill recently brought forward by the President of the United States, proposes, while allowing trusts to continue, to control all interstate trade by a commission to be known as the Interstate Trade Commission. This Commission or its authorized agents, is to have complete access to all records, accounts, minutes, books and papers of corporations, and will thus be able to ascertain if such corporations are violating the famous Sherman Act or a new measure to be known as the Trade Relations Bill, which provides that it shall be deemed an attempt to monopolize trade or commerce for any person to discriminate between different purchasers of commodities in the same or different sections or communities, or to make rebates from list prices on condition that the purchasers of their goods shall not handle the products of their competitors.

Why Are Monopolies Detested?

What are the abuses of monopoly against which these measures are directed? And why are the people thus disposed to crush monopolies, though such monopolies may be the most efficient of producers?

In the first place, monopolies are detested because of their very name—because monopoly implies special privileges—the exclusive right of selling something—and special privileges are obnoxious to a democratic society. Such a community does not like to feel that John D. Rockefeller, for instance, is in control of the United States' supply of oil, can at any time crush out the small competitor whom he encounters and hold up the people of the United States for the oil. He is an "oil king," absolute and despotic, and the people of the United States do not like even constitutional monarchs. To Canadians too the despotism of such a corporation as the Standard Oil Company is very obnoxious.

The abuses of monopolies are, however, not only sentimental; they are exceedingly practical; otherwise so practical a people as those who reside on this North American continent would hardly have acted so vigorously against them. These practical abuses may now be considered.

The Trust is the Enemy of the Competing Producer.

The trust is able to crush competitors by three kinds of alleged unfair dealing. The first of these is local discrimination in prices. The trust, being the largest producer in its field, may sell goods for less than cost in some parts of its territory, provided that it makes enough in other parts to continue operating at a profit. The smaller producer is thus driven out.

"Do you not see," said an independent producer once, "that in my territory I can produce more cheaply than you can?"

"Do you not see," replied the manager of the trust, "that if we lose money in the twenty cities where you are operating, and make money in the two hundred other cities where we are operating, we come out ahead?" This policy is effective in keeping down small but rising competitors.

A second means used by the trust is, in cases where it produces many lines of goods, and its competitor only one, to cut its prices on such part of its product as competes with his, while maintaining or even increasing its prices on other products. This will be just as effective in putting him out of business as the first method.

A third scheme adopted by the trust is that of refusing to sell goods at all except under certain conditions. It may and often does boycott merchants who will not promise to deal exclusively in its goods and refuse to handle those of its competitors. Under these so-called "factors' agreements," a trust that has a number of products essential to a merchant's business, may refuse to sell him anything, unless he agrees to cease handling the goods produced by the trust's competitors.

In these and in many other ways the trust, with its great capital and enormous power is able to crush its small competitors and reign supreme over a field of ruins. However, for one reason or another, perhaps as a concession to public opinion, perhaps because the game is not worth the candle, most trusts do not pursue the warfare against their competitors to the bitter end, as long as these refrain from cutting prices and are content with only a small share of the trade while the bulk goes to the trust. Such competitors, however, exist only on sufferance, and generally adopt the same or practically the same scale of prices as the trust itself. Their continued existence, therefore, while no doubt very satisfactory to themselves, constitutes no protection to the public against the monopoly prices charged by the trust.

The legislation proposed by President Wilson seems to be carrying out the ideas of Prof. Clark of Columbia University. Laws which would give to every customer of a trust the right to buy from the trust at the same rate, would prevent the operation of the first and third schemes for driving out competitors—that of local discrimination in prices and that of refusing to sell to retailers who handle competitors' goods.

Difficulty of Preventing Trust From Underselling or Refusing to Sell.

But however desirable such laws may be, the legislator must also consider how far their enforcement is practicable, and whether it is really possible to prevent a trust from selling its products cheaper (transportation costs of course eliminated) in one place than in another, or to prevent them selling more cheaply to one person than to another. To bring this to pass would require a much greater efficiency of administrative supervision than has existed up to the present in the United States or Canada.

The Trust and the Investor.

We have now shown how the competitor and how the consumer of the trust's products suffer from the methods used by the trusts and how it is proposed to deal with their case. The competitor and the consumer, however, have not been the only sufferers.

The Small Investor Has Also Lost by Investing in the Common Stock of the Trust.

When a trust is being formed, financiers usually called promoters go from one producer of a commodity to another, making arrangements for the purchase of their plants in case the venture is a success. They usually propose to pay the vendors of these plants in preferred stock or in bonds of the trust (thus Mr. Carnegie sold his steel plants to the United States Steel Corporation for $320,000,000 of 5% bonds of the United States Steel Corporation), and usually they pay more than the plants are really worth. Then they issue other stock, preferred or common, retain the better class of this for themselves, and get rid of the common stock to the credulous public, which is fascinated by the prophecies of high dividends on the trust's common stock and consequent increase in the price of that stock—prophecies which do not usually "pan out." The promoters make money out of the big block of stock which they have retained for themselves and which they keep if they think that it will pay them to do so, or sell to the public if it will not. Hence, besides all the bonds and preferred stock which together usually amount to the full value of the plants which constitute the trust, there is generally issued and sold to the investing public a vast quantity of common stock in the new trust.

Watered Stock.

In almost every case where a trust has been formed (the Standard Oil Company is the notable exception), the capitalization of the trust has been vastly in excess of the capitalization of the corporations which entered into it. These corporations have received stock amounting to at least as much as their own previous capitalization in return for their investment in the new concern. What does the excess capital mean? The man in the street calls it "water," and to issue it is commonly regarded as illegitimate. But "watered" stock is not usually issued in the belief that it will never be worth anything. It is issued as a capitalization of the prospective earnings of the trust. Why should the trust earn more than its constituent companies taken together? Because it has a more or less complete monopoly of the market. The excess in capitalization, therefore, represents somebody's estimate of the capitalized value of the prospective monopoly profits.

Profits of Trusts Smaller than Anticipated.

Now the persons who organized the various trusts during the past generation have usually, to put it mildly, been excessively optimistic as to the prospective monopoly profits which their trusts would earn. Possibly some of them even deliberately overcapitalized their trusts in order to make more money out of them. When the stocks of these trusts were placed upon the market, they were sold to the public at a fairly high price. Then the trusts and monopolies finding that they could not in practice secure the monopoly profits which had been estimated (see remarks on the limitations of monopoly, Lesson 7, page 10), were unable to pay dividends on their common stock, which was largely held by the public. The result was that the price of such stock very rapidly declined. Thousands of investors were thereby ruined and millions of capital which had been invested in these concerns were lost—or perhaps it would be more correct to say transferred to the pockets of the promoters of the trust.

The process is well described in the Report of the American Industrial Commission:

"The profit of the promoter is generally that portion of the stock issued, that is left after paying for the plants entering into the combination and the expenses of the organization. Usually, therefore, the amount paid for the plants is not known to the investing public; the amount received by the promoter is not known to the vendors themselves; at times no careful estimate is published of the value of the tangible assets; even the earning capacity of the different plants is not always made public. In consequence, the speculative element in the value of the shares for the first few months after the organization, is possibly the most important feature in connection with them.

"The larger combinations usually issue to their stockholders once a year an annual report regarding the business. This report, however, is frequently in terms so general that it is difficult to learn much regarding actual conditions, and this speculative element still remains.

Directors Take Advantage of Shareholders.

"This secrecy in promotion, combined with very large capitalization, gives a great advantage to directors and officers of the combination and others associated with them in knowing the value of the shares. There seems to be no doubt that in many instances the promoters of combinations have been able to unload large blocks of stock at prices far above their values, as shown by later experience. Parties interested in the International Silver Company attempted by a pool to unload stock at 30, which soon afterwards fell to 12. At other times insiders might be able to take advantage of the public in the stock market, as was charged against an officer of the American Steel and Wire Company, and there is no question that some of them do take such advantage of stockholders for whom they are acting substantially as trustees."

Small Investors Suffer From Trusts.

The small private investors, then, have suffered from the trusts only less than the consumers, though we do not hear nearly so much about them, probably because they are fewer in number. In Germany such a position as theirs would have been impossible. The law there (and German laws are fairly well enforced) provides that the capitalization of a company must not exceed the actual investment, in stock or cash, in that company. Of course in Germany, as in any other country, some corporations fail in business, but at least the dice are not loaded against the small investor. When such an investor buys a $100 share, or what corresponds to it, in a German stock exchange, he knows that in the beginning at least, it represented an actual investment of that amount. This is far—very far indeed—from being the case in the United States, England, or Canada.

Canadian Combinations.

In the past few years, combinations of various kinds have been formed in Canada on the model of the American trusts. The year books published by the Monetary Times in 1913 and 1914 give lists of such combinations extending over several pages. The capital of these combinations and the capital of their constituent units are given, and it is only in rare cases that the bonds and preferred stock alone of the combination are not equal to the bonds, preferred and common stock of its constituent bodies. If, then, the amount of stock in the constituent bodies actually represented the value of the property turned over by them to the combination, the common stock of the combination represents no actual investment and may be said to be only the capitalized value of prospective monopoly profits yet to be earned by the combination. Most of these combinations—for instance the Canada Cement Company —have not yet paid any dividends upon their common stock, which apparently does not represent any actual investment, but is merely the capitalized value of prospective earning power. This is, indeed, the case with a great many of our industrial combinations, as any one can see for himself by consulting the Monetary Times Year Book.

Canadian Legislation on Combines.

What has been done in Canada to limit the powers of monopolies? So far not a great deal. The general disposition has been to rely upon the common law. In 1888 a committee was appointed by the Dominion Parliament to investigate and report upon alleged combinations in manufactures, trade, and insurance in Canada, and the anti-combines legislation of 1889 which resulted from their report was merely declaratory of the common law on this subject.

Another way in which combines were attacked was by removing the duty on the monopolized article. Thus, as a result of a combine which unduly enhanced the price of paper, the duty on paper entering the country was in 1900 reduced from twenty-six per cent. to ten per cent.

The Combines Investigation Act.

These earlier measures proved inadequate and unsatisfactory, and in 1910 a Combines Investigation Act was passed, which is, in many respects, modelled on the Industrial Disputes Investigations Act of 1907. Under this Act, any six consumers in Canada who have reason to believe that a combination which has unduly enhanced prices exists in any department of industry, may apply before any High Court for the appointment of a Board of Investigation to report upon the alleged combine. If they can produce reasonable evidence in support of their contention, a Board of Investigation is appointed, consisting of three persons, one appointed by the complainants, a second by those accused of being in the combine, while the third who acts as chairman, must be a judge chosen by the other two or by the Minister of Labour. Where it is shown that a combine exists and is favored by the customs tariff, the Governor-General-in-Council is given authority to reduce or abolish the duties on the monopolized articles. Further, if the combine is found to have unduly enhanced prices or restricted competition to the detriment of consumers, a penalty of $1,000 a day is provided, unless the offending parties desist from the combine within ten days of the publication of the Board's report.

It is as yet too soon to speak with confidence of the results of the legislation of 1910.* Two things are evident—the chief weapons of the Government are public opinion and the customs tariff. These in the hands of an administration resolute to enforce the law, should be effective, especially since very few of the Canadian combinations are strong enough to survive against American competitors if the tariff barrier were once removed. Would-be monopolists in this country must, therefore, account discretion the better part of valour and cannot openly defy public opinion as do the enormous aggregations of the United States.

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*No case under the Combines Ivestigation Act, has, I understand, as yet been tried.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XVII.

1. Show that the monopoly profits on a commodity will, under like circumstances, never be less than competitive profits on the same commodity. (Refer also to Lesson VII.)

2. What is a pool? Enumerate and describe the different kinds of pools.

3. Why has the American pool proved to be an unworkable form of organization? Compare the American and the German methods of dealing with the pool or kartel.

4. Explain the process of forming a trust.

5. Under what circumstances was the trust replaced by the holding company? Give an example of a holding company.

6 State the substance of the proposed anti-monopolistic measures of the American Government.

7. Against what abuses are the measures referred to in the previous question directed? Explain fully.

8. In what ways have small investors suffered from the existence of the trust? How are they protected in Germany?

9. What are the causes which lead to the issue of watered stock? Explain the promoter's point of view.

10. Discuss the rise of combinations in Canada and give the substance of the legislation enacted against them. Why are Canadian combinations less formidable than those of the United States?

ECONOMICS

LESSON 18

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ECONOMICS

LESSON XVIII.

Socialism.

THE problems of modern business—of labour, of transportation and of monopolies—have been discussed in lessons XV., XVI. and XVII. Incidentally, we have learned (if we did not know it before) that the world of to-day is by no means a place where ideal justice prevails and where every man obtains that which he merits, and every man merits that which he obtains—where industry and ability are always suitably rewarded, and the faithful and energetic worker will always surely rise to the top. We have seen that a man may make a fortune by humbugging as well as by serving the public; that the wealthy monopolist can ruin a struggling rival who may have greater business ability but less capital; that promoters may make great fortunes out of the investing public without performing any adequate service in return; and that real estate speculators may make great fortunes out of the unusual appreciation of land values which they have done nothing to create.

Socialists and Communists.

It is not at all wonderful, therefore, that moralists and reformers of all the civilized or semi-civilized ages, from the time of Job and that of Horace to the present day, have lamented that the rewards of men are not in proportion to their merits, nor that, from the time of Plato, idealistic philosophers have attempted to construct ideal societies in which a juster distribution of wealth should obtain. Some of the writers have held that every man should be rewarded according to his deeds, which would apparently imply that a competent carpenter would receive more than an incompetent; others, again, have claimed that every man should be rewarded according to his needs, which are usually presumed in such works to be equal. The first of these groups of men are the Socialists proper; the second may be classed as Communists. These two groups cannot, however, be clearly distinguished from each other in practice, and since Socialism is the more common of the two ideas, we often find people described as Socialists who are really Communists.

Now we do not hold a brief either for the present order of things nor yet for the ideal commonwealths of the Socialists and Communists. The defects of the present economic system of distribution—and very regrettable they are—actually exist, and can easily be seen, while the probable defects of the proposed Socialistic organization of society—its numerous officials, the utter impossibility of estimating justly the real value of everyone's work, the lack of incentive to effort—cannot be clearly realized in advance, though the State's failure to treat its public servants justly and discriminatingly is a widely observed phenomenon of our modern life. Would the Socialists be any more able than the existing State to appreciate at their proper value all the citizens and do actual and entire justice to them all? This question cannot be answered offhand; but there is certainly a very large element of doubt.

Many Kinds of Socialism.

Since Socialism is something that exists only in men's minds, and since there is no actual case of a Socialistic community on a large scale, Socialism means many very different things to different people. Everyone is entitled to form his own conception of it and to print his version of the ideal State if he will. Various main ideas are, however, to be found in almost all such schemes; for instance, the idea that the wage-earner does not get enough of the value which he creates, and that it is desirable that his share should be increased at the expense of others who profit by his work—the landlord, the capitalist, and the entrepreneur. Indeed Socialists of the

Marxian school say that these latter have no claim to any share at all.

Marxian or "Scientific" Socialism.

Now we cannot undertake to go into all the different kinds of Socialism and to explain their theories; yet, we may attempt to state the main principles of that theory of Socialism which commands the widest allegiance, and is the principal basis of the Socialistic movement in the United States and Canada, as well as in Germany. This is the so-called "scientific" Socialism—the Socialism of Karl Marx. In the Presidential election of 1912, over 900,000 votes were polled for Eugene V. Debs, the Socialist candidate for President of the United States; this indicated an enormous increase, as compared with 1908, in the strength of the Socialist movement. This American Socialist movement is based on the teaching of Karl Marx, and as this movement has also invaded Canada, and most Canadian Socialists are of this type, it is important for us to consider Marx's teaching, and where it seems to be most at fault.

The Economic Interpretation of History.

The ground-work of the whole doctrine of Marx is the doctrine known as the economic interpretation of history—the idea that the whole civilization of a people, their literature, language, laws, form of government, and even their religion itself, are a consequence of their method of earning their living and their success or lack of success in so doing.

Marx holds that the life of a society resembles the life of an individual in being a period of ceaseless change, and that the ideas and institutions of each period in that life are necessarily relative to the economic condition of society at that particular time, and that all other social institutions—the church, the courts, the literature—of a country arise in the first place out of its economic conditions and changes. The political constitution and the laws of a country are determined by the economic requirements of the governing class, and all history is filled with struggles between the classes in a country—class conflicts. Of these struggles, the first type is that between the land-owning feudal nobles and the citizens of the trading-towns, whom Marx calls the bourgeoisie. These struggles ended in the overthrow of the feudal nobility and the rise to power of the capitalistic bourgeoisie, who are now the masters of our society; but the time is destined to come, and is even now on the way, when the supremacy of the capitalistic bourgeoisie shall be overthrown by the labouring masses known to Marx as the proletariate. These people, whether with ballots or with bullets, will assume control of all the means of production and of the process of distribution, and will thereby stop the legalized exploitation of the wage-earner by the capitalist, under which name the Socialist includes the entrepreneur as well as the person whom we call the capitalist.

Struggle of Proletariate and Bourgeoisie.

How have the members of the proletariate been exploited by the bourgeoisie? Marx claims that all the inventions made at the time of the Industrial Revolution have contributed only to increase the wealth of the upper classes and have in no wise helped to brighten the lot of the poor. This, it is generally recognized, is untrue to-day; but when Marx wrote his great book, Capital, it was probably true enough that bodies of workers led a life no better than they had led a century before; that the purchasing power of their wages was, if anything, less than it had been in the previous century, and that the greatest distress prevailed, especially in those home industries where the hand-workers attempted to keep up an utterly futile competition with the machine workers. Marx at that time had too many facts on his side to be laughed out of court.

Times have, fortunately, changed. It is probable that at no period in the past has the condition of the working-classes in England, France, Germany and the United States—to name only the four leading industrial nations—

been superior to what it was in the first decade of the twentieth century.* Marx, however, had expected that the poor would go on getting poorer and the rich richer, until finally the wage-earners, goaded on by the intolerable hardships of their lot, and incensed by the increasing luxury which they saw around them, would rise in their millions, drive out their masters, and establish a communistic society, where every man should be in actual fact what he even now is in name—free and equal. The failure of his prediction has taken some of the wind out of the Marxian sails.

Evolutionary Socialism.

As a consequence of this failure, there has arisen in the Marxian ranks a sort of higher criticism of the "Socialist Bible"—Marx's great work, Capital. The people engaged in this criticism are known as the Revisionists, and their intellectual leader is Edward Bernstein, a German writer who, rejecting Marx's doctrine of revolution, believes that a Socialistic society will, in time, be introduced through a gradual evolutionary process instead of by a violent upheaval such as the French Revolution. The Revisionist school, however, have as yet made no great impression upon the Socialist movement in America. On this continent nearly all out-and-out Socialists are Marxians.

The Labour Theory of Value.

How does the process of exploitation spoken of by Marx go on? Marx follows Smith and Ricardo in maintaining that labour alone creates value. "Labour," says Adam Smith, "was the first price, the original purchase-money that was paid for all things." Ricardo quotes Adam Smith, and continues: "That this (labour) is really the foundation of the exchangeable value of all things, excepting those which cannot be increased by human industry, is a doctrine of the utmost importance in political economy. If the quantity of labour realized in commodities regulates their exchangeable value, every increase of the quantity of labour must augment the value of that commodity on which it is exercised, as every diminution must lower it.''

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*Statistics quoted in Lesson XIII. show the increase in recent years of both money wages and real wages.

The value of a commodity is, therefore, according to Marx, the amount of abstract human labour embodied in it, and commodities ought to exchange for each other in proportion to the amount of labour which it costs to produce them. If a ton of coal costs, on the average, one day's labour, and two yards of cloth cost one day's labour, then the ton of coal ought ordinarily to exchange for the two yards of cloth. Or, if we are dealing in terms of our common denominator, money, we should say that one ton of coal costs as much as two yards of cloth. Commodities intended for exchange may, therefore, says Marx, be described as crystallized labour, and the value of the article is measured by the length of time which, on the average, is necessary to produce it.

Marx's work were written before the utility theory of value (see Lesson I.) came into common acceptance. He was in harmony with the best economists of his time in holding what is known as the Labour Theory of Value. Marx errs, but in very excellent company.

Surplus Value.

Labour itself has, especially in these days of machine production, the unique property of producing more than is required to maintain the labourer. The capitalist pays for labour its cost of production (see Lesson XIII., page 7), and receives in return its product, which is worth more than it costs him. The labourer can, let us say, produce in six hours enough to keep himself and his family. Now the capitalist is able to make him work ten or twelve hours, and is able to appropriate the goods produced in the extra four or six hours, or at least the value of these goods. The first six hours' work is what Marx calls ''necessary labour''; the value produced in the other four or six hours, the return for which goes to the capitalist, is what he calls ''surplus value''—a very important term in the Socialist vocabulary. The capitalist puts this ''surplus value'' into his pocket and uses it, let us suppose, to set up machines which will make his labourers do still more work and become more efficient. If by introducing labour-saving machinery, the capitalist can succeed in reducing the necessary labour time to four or five hours, he will then have a larger product to retain for himself.

Marx regards this as unjustifiable exploitation of the workers. They and not the capitalists should secure the advantage proceeding from the use of labour-saving machinery.

Capitalism a Necessary Stage.

The capitalistic era is, according to Marx, a necessary epoch which must, in time, give place to communistic production. Capitalistic production through the exploitation of the worker destroys its own market, since the worker has no money left with which to make purchases. Therefore, capitalistic countries, that is countries where the factory or capitalistic system of industry is predominant, are compelled to seek foreign markets for the goods they produce. For a time they can do this successfully; but when all the foreign markets are flooded with surplus commodities, when capitalistic industry develops in all countries, capitalism will end by working out its own ruin.

The Concentration and Expropriation of Capital.

One great capitalist, he holds, ever kills many small ones. Through the absorption of many capitalists by few —the trust movement—are developed large-scale production, the co-operative form of the labour process, the intelligent application of science to industry, the systematic exploitation of the soil, the bringing together of all the nations into one world market, and an era of international capitalism. The large capitalists are continually swallowing up the small capitalists, and thus the capitalist class declines in numbers, while the exploited labourers are continually increasing in numbers, and are finding it harder and harder to make a living. The centralization of the means of production finally reaches a point where the capitalists can no longer resist the determination of the people to expropriate them. They, the expropriators of the property of smaller men, are in turn expropriated by the State and a communistic system of society is established.

Marx would make land and all the instruments of production collective property, and would have all subjects of the State share equally in labour and in the produce of labour. Thus his prospective Communist State is a Labour State, in which labour will be compulsory on all able-bodied citizens.

The Mistakes of Marx.

Marx was, fortunately for humanity, entirely wrong in stating that all industry is becoming concentrated in the hands of a few. Though, as we have seen, there is a strong tendency toward the increase of large-scale business, it cannot be said that small-scale business, as a whole, is on the decline. Small retail shops exist in thousands in our cities by the side of the great department stores, and hundreds of thousands of farmers own and manage their own land. The same is the case in other countries. Out of a total of 8,333,000 employees in the trade, industry and commerce of Germany in 1907, practically 3,000,000 were employed in businesses having five or less employees, and over 2,000,000 more in medium-sized factories employing from six to fifty persons. These results are all the more impressive because they do not include the agriculturists.

The rich also were, according to Marx, becoming ever richer, while the poor became poorer. This, again, is erroneous. In Saxony, to quote the figures of Bernstein, proletarian incomes of $400 or less a year increased in number only 33% between 1879 and 1894, while incomes of from $400 to $2,400 increased over 70%; those from

$2,400 to $13,000, 154%, and incomes of $13,000 or over, 272%.

The Labour Theory of Value Given Up.

The ideas on which Marx based his Socialism must, therefore, be given up. His labour theory of value is erroneous, and has now been generally abandoned. If labour is the measure of value, say his critics, what decides the value of labour itself? Or in the case where a shoe goes through fifty hands in the process of manufacture, who shall decide on the Marxian doctrines what amount each of the men has contributed to produce the finished article? One can estimate the total value added to the leather in manufacturing the shoe, but one cannot estimate how much of the added value is due to each of those who have aided in the process. Yet, that, according to Marx, is what should decide their reward.

Again, if labour is the measure of value, why is it that no one will buy at any price a disused railroad? It cost a very great deal of labour to build the railroad, perhaps as much labour as it cost to build a much used and productive line of railway; yet no one but a lunatic would be willing to give the latter for the former. Clearly, the labour theory of value will not square with the elementary facts of life. If we compare it with the utility theory of value (Lesson 1) we shall easily realize which of the two coincides with our experience.

It is, however, a great mistake to suppose that because we have refuted the Labour Theory of Value we have thereby disposed of Socialism. We have, indeed, disposed of the pure Marxian or "Scientific" Socialism, but there are other varieties, less revolutionary, indeed, but on that account all the more pervasive and, as the opponents of Socialism would say, all the more dangerous, because, like some of the most deadly diseases, they are insidious.

The Fabian Society.

The type of Socialism which is to-day producing the greatest practical effect is probably that whose influence is being seen in the legislation of the present government of the United Kingdom. It is the type of Socialism propounded by the Fabian Society, an organization which derives its name from the Roman General, Fabius, who refused to fight with Hannibal, the great enemy of Rome, until he was quite ready. Its motto is: "For the right moment you must wait, as Fabius did, most patiently, when warring against Hannibal, though many censured his delays; but when the time comes you must strike hard as Fabius did, or your waiting will be in vain and fruitless." The objects of this society are given in its own words.

"The Fabian Society consists of Socialists.

"It therefore aims at the reorganization of society by the emancipation of land and industrial capital from individual and class ownership, and the vesting of them in the community for the general benefit. In this way only can the natural and acquired advantages of the country be equitably shared by the whole people.

"The society accordingly works for the extinction of private property in land, and of the consequent individual appropriation, in the form of rent, of the price paid for permission to use the earth, as well as for the advantages of superior soils and sites.

"The society, further, works for the transfer to the community of the administration of such industrial capital as can conveniently be managed socially. For, owing to the monopoly of the means of production in the past, industrial inventions and the transformation of surplus income into capital have mainly enriched the proprietary class, the worker being now dependent on that class for leave to earn a living.

"If these measures be carried out, without compensation (though not without such relief to expropriated individuals as may seem fit to the community), rent and interest will be added to the reward of labour, the idle class now living on the labour of others will necessarily disappear, and practical equality of opportunity will be maintained by the spontaneous action of economic forces with much less interference with personal liberty than the present system entails.

"For the attainment of these ends the Fabian Society looks to the spread of Socialist opinions, and the social and political changes consequent thereon. It seeks to promote these by the general dissemination of knowledge as to the relation between the individual and society in its economic, ethical and political aspects."

The Revisionist Socialists.

The revisionist Marxians of the Continent of Europe have themselves adopted a system of evolutionary Socialism, not greatly different from that of the Fabians, except that, on account of their continental position and the military conscription which this involves, they turn a great part of their wrath against the immense standing armies of such countries as France and Germany, and declare that the workers of these countries must not fight each other, but must rather make common cause against the predominant military caste best represented by the Junkers of Prussia—their oppressors. They still retain as their watchword the closing words of the Communist Manifesto, drawn up by Karl Marx and his friend Engels, in 1848:

"The proletarians have nothing to lose but their chains. They have a world to gain. Workers of all countries, Unite!"

These two bodies, therefore, are in sympathy not very far removed from each other. They both believe in the advent of Socialism through governmental action, though the Fabians in England prefer to work for Socialism rather as a pervading influence in the older English parties, while the Social Democrats of Germany and other Continental countries have growing political parties of their own. Both in England and on the Continent they are gaining ground. Much of the social legislation of the Asquith Government is Fabian in origin, while the cities of the Continent are constantly trying new Socialistic experiments. In the general election of 1912, in Germany, over 4,000,000 voters supported the Social Democratic party—an increase of nearly a million over the previous election.

Growing Strength of Socialism.

The Socialistic movement is at present, beyond all question, advancing, though no one can say how long that advance may go on, or whether Socialism will not in the end content itself with measures much more moderate than those now proposed, since there seems to be a growth of a more temperate, a more compromising, spirit in the movement as it grows older and wiser. But if this is the case, we may expect to find, and indeed we are finding, that the more extreme among the Socialists are denouncing their parliamentary party for compromising with the great enemy, capitalism, are giving up their belief in the efficacy of governmental action, seceding from the Socialists and establishing a new movement of their own, based on the principle of "direct action." These secessionists from the older Socialists have received the name of Syndicalists.

The Syndicalists and "Direct Action."

What do they mean by "direct action"? They assert that the action of Parliamentary Socialism is dilatory and uncertain, and that the only hope of the worker is to disregard the representative, who is merely deluding him, and work out his salvation for himself by taking possession of the machinery of production. Does this involve violence? Not necessarily. The syndicalist theory is that if a group of workers—say the railway workers—refuse to work themselves, and if no others can be found to operate the railways, the railways will lose all value; railway shares will be worth nothing because the railways will have no earning power. When the shares become valueless the shareholders will be willing to make the workers a free gift of the railway. If they will not, the workers will take it anyway. The same might be done, also, with the other industries of a community.

The General Strike.

Thus by this great device of the "general strike," all the machinery of production—the land, the mines, the forests, the railways and the manufactures of the world—would come into the hands of the workers, who, in addition to all the wages which they receive, would also get the interest which now goes to the capitalist and the profits which now go to the entrepreneur.*

Short Strikes and "Sabotage."

In a country where the bulk of the workers are not yet educated up to the general strike, the Syndicalists would prefer short strikes rather than the long strikes which occasionally occur to-day. They believe that a series of short, sharp, unforeseen strikes, each of a few weeks' duration, injures the employers much more and the employees much less than a single long strike, which leaves the union exhausted, whether by victory or defeat. Between these short strikes, too, the Syndicalists, since all weapons are legitimate against the monster capitalism, would advocate the practice of what is known by the French name, "sabotage." Sabotage means anything which can be done to hurt the employer for whom one is working. It comes from the French word, "sabot," a wooden shoe. It originated in the action of some French peasants who, after a quarrel with their employer, threw their wooden shoes into his fine silk-weaving machines and ruined them. To-day sabotage may mean dropping petroleum into the kneading-trough, short-circuiting an electric current, delaying cars in transit, or changing the labels on freight-cars and sending to Vancouver a car originally labeled for Halifax. In the case of a lumber company, it would mean putting nails in the wood to be cut by the circular saw. Any one of the million ways by which a discontented employee may injure his employer comes under the head of sabotage.

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*Practically all Socialists would appropriate economic rent for the service of the State, so that our syndicalists would not receive that.

The Failure of the General Strike.

Fortunately, the success of the Syndicalists has not been in proportion to the violence of their methods. The general strike has been tried in a number of different countries within the past few years, and the most prominent result has been to create in the majority of people an utter loathing for the Syndicalists and all their methods of procedure. That is not strange, since the public is after all the greatest loser by a stoppage of the railways or any other great industry. The tying up of the railways, for instance, means that the cities no longer have their accustomed supply of food; that prices go up, and all suffer, and that the poor of the working class suffer most, since they have the least money for purchasing food. Under such circumstances it has been and always will be found that public opinion supports the Government in forcibly protecting the companies operating the railways or in forcibly operating them itself. Thus, a few years ago, during a general strike in France, the Government called up the railway men who were in the army reserve and compelled them to operate their lines under martial law.

Syndicalism on the Decline.

The consequence of the failure of the general strike when carried out in practice has been to discredit the whole Syndicalist movement, and we may dismiss the subject by saying that, in Europe at least, that movement is now on the decline.*

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*The Syndicalist methods are represented on this continent by the "I. W. W."—Industrial Workers of the World. This organization has had a certain vogue, since it finds a field for its activities among the immigrant workers of the Latin and Slavic nationalities, and among the Jews—people who are not admitted in any large numbers to the less radical American Federation of Labor.

Criticism of Socialism.

We have completed our survey of the chief Socialistic movements. We shall now proceed to discuss them.

Wealth Production Still Small.

In the first place, the Socialists generally talk of the enormous wealth of the rich, and argue that if this were divided equally among all men there would be enough for all. They forget that the number of the wealthy is very small, as compared with that of the poor, and that there are practically no countries in the world where the total income of the whole people (which some economists call the National Dividend) would, if divided up equally, give the average family much more than $1,000 per annum.* In the United States, Canada and Great Britain, and possibily in France, it may at present reach $1,200 per annum. This amount per family would indeed give everyone a fair living; but it is questionable whether a decline in the average income would not probably occur after the adoption of Socialism on account of the inefficiency, the non-businesslike character of its governing body, though it is possible that the saving resulting from the abolition of many non-economic occupations of the present day would make up for this. Among such occupations one might include commercial travellers, advertising agents, etc., such as are eliminated in considerable numbers when an amalgamation takes place among the firms supplying a certain territory with a certain product. Other great classes of work would also be done at much less expenditure of effort; for instance, one dairyman, one baker, one iceman would serve a whole section of a city, just as one postman does now. Possibly the gains in this way would make up for the loss entailed by the unbusinesslike methods of government.

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*Socialists often claim to be internationalists. If they took the globe as their unit and divided the world's products equally among all the families in the world, the average family would not have more than $300 per annum.

Difficulty of Securing Capital in a Socialist State.

There is no doubt something attractive in the idea of a State where incomes should be equal and at the same time sufficient to provide moderate comfort for everyone. But there are yet other difficulties in the way of establishing such a State. This State must be what Mill calls a stationary State—a State where capital is not saved up, and where progress does not go on from year to year. It is conceivable that in some of the smaller European countries such a condition might exist; but how could it exist in Canada, in a country where, for generations to come, there will be great need of capital for development? Under Socialism no one would have any motive for not spending every cent of his income, since he would not receive any interest on it. Nor could a State which refused to pay interest on capital lent to it by its own people, consistently pay interest on capital borrowed from abroad. Indeed, if other countries were Socialistic also, they would not have any capital to lend.

Socialism Implies a Stationary State.

Presumably, then, a Socialist régime would mean a cessation of railroad-building in our country and a stoppage of the work of opening up the country and increasing its productivity. The Socialist might assert that the cost of such development would be met from the rent coming into the State Treasury from the developed land. The answer is "Certainly, but this gain must be subsequent to the development. You have first got to borrow the capital necessary to develop the new sections of the country, and you cannot consistently do that. Therefore, you cannot develop the new territory, except that a few millions of the surplus income of the State, proceeding from land rent, might annually be devoted to such work." Compare this trifling sum with the hundreds of millions which are now being invested yearly, both by Canadians and outsiders, in the development of Canada.

For a new and developing country, Socialism is, therefore, impossible. To older countries the foregoing arguments would not apply, but there are others arising out of the very nature of man as it exists at the present time.

Socialism and Human Nature.

The most important of these may easily be illustrated from our own experience. Is a man who feels more capable and knows that he does more work and is more valuable in his position than his neighbour, satisfied with a salary equal to that of the latter? Some may be, but this is certainly not the feeling of the average man. He will first probably ask for a raise in his pay; but if he fails to get it, and if his salary increases merely with his seniority, or not at all, he will say to himself, "I don't get more than the other fellow. Why should I do more than he does when I am not getting any more for it?" Imagine this average man multiplied by millions, and all these millions slowing down in their efforts, and one can form an idea of the decrease in the National Dividend which would follow the introduction of Socialism.

Business men know that in order to bring their industries up to the maximum of efficiency, they must adopt, in dealing with the staff, the principle of what Napoleon called "the career open to the talents." That is, they must be prepared to give promotion and higher pay to the good executive officer or employee in order that he may be encouraged to do still better work. They must not let seniority stand in the way of promotion, else the ambitious and energetic men will pass from their service to that of their competitors. If this is the case in business, is it not ruinous to adopt for one's country a system which gives to the active and energetic man no advantage over the drone?

Socialism Would Necessarily Fail at the Present Time.

It is hopeless, therefore, this attempt to cure all the ills that flesh is heir to by superimposing a Socialistic system of economy upon such an individualistic society as exists upon the North American Continent. Such an attempt would certainly come to grief, as in the case of the small groups of people who at various times and places have attempted to conduct their lives on communistic principles. These groups might be expected to consist of people who naturally were in sympathy with Socialistic ideas. If these few picked enthusiasts failed, what hope is there that the great unprepared masses would take kindly to the Socialistic system?

Possibilities of the Future.

Human nature is, however, as historians and biologists know, a changing thing. There is probably more unselfishness, more altruism, in the world now than in former times, and it may be expected that, in future ages, there will be more of devotion to the common cause than there is to-day. In some society of the future the ideals of the Socialists may be at least partially realized. A time may come, according to the great scholar and philosopher, Jowett, when the question, "Have I not a right to do what I will with my own"? will appear "a barbarous relic of individualism." He would be a bold man who would venture to predict that the individual motives will always be stronger than the social motives toward industry.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XVIII.

1. What is the distinction in theory between Socialists and Communists? Discuss.
2. Explain clearly what is meant by the "economic interpretation of history," as understood by Marx.
3. Prove (referring also to Lesson XIII.) that the wage-earning class is not, as Marx thought, becoming poorer.
4. What, according to Marx, is "surplus value," and how does it come into existence?
5. What was Marx's idea of the future of capitalism? How have events corresponded to his theory?
6. What is meant by the "Labour Theory of Value"? What writers are responsible for it? Explain how it has been refuted, and state what theory is now held.
7. What is the policy of the Fabian Society?
8. Explain the reason for the revolt of the Syndicalists against the older Socialism.
9. What is meant by the terms "direct action," "general strike," "sabotage"? Give examples from recent magazine articles and daily papers.
10. Criticise Socialism from the point of view of the present state of wealth production.
11. Is Socialism a practical policy for twentieth century Canada? Discuss fully.

ECONOMICS

LESSON 19

By

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ECONOMICS

LESSON XIX.

Public Finance.

Part I.

THE first thought of the student who, through all the stages of the previous lessons has reached this point, may possibly be, "What has the Government to do with Economics?" If, however, he will think over his previous work, he will be ready to admit that a Government has a good deal to do with the monetary and banking systems, with grants of land from the Crown, with labour, transportation and monopoly problems. Under Socialism, of course, the Government would be all-powerful in the sphere of economics. But far removed from Socialism as we are, careful consideration of the subject will show the vast influence which a Government has upon the economic affairs of the citizens.

Functions of Government at Their Minimum.

Even though, as Adam Smith desired, the functions of Government were to be reduced to the minimum (affording protection to the life and property of the citizens against domestic or foreign enemies, and undertaking such public works as are too great for individuals and yet necessary to the community, for example, the Panama Canal), yet we should find that by its method of performing or neglecting to perform those functions, the Government would exercise an enormous influence over the economic welfare or adversity of its subjects. In Turkey, for instance, life and property are far from being secure, and the result is that no one cares to save up capital or to invest it there, with the further consequence that the transportation service, etc., of that country is inadequate, that the country, in spite of enormous natural resources which once supported a dense population, is now thinly settled and backward.

The Increase in the Functions of Government.

Much greater is the influence of a Government which, like most modern Governments, considers that its functions embrace, besides the foregoing, education of various kinds, the construction of great public works, the management of great public services, and the control of the great industries of the country. Such a Government can, by an enlightened and progressive policy, rapidly increase the production of wealth, or by a mistaken policy, though with the best intentions, bring the country to the verge of ruin.

All governments require for the proper discharge of their functions, large sums of money which are collected from the inhabitants of the country. All the public revenue is collected from the pockets of individuals either in return for some special service performed by the government (such as the postal service) or as taxation. The study of the best methods of its collection and expenditure is called Public Finance.

Increase of Revenue Necessary to Perform Functions.

Now as the functions of the State in almost all civilized countries are being extended, it is evident that the cost of supporting the State must be increasing. And this is what we find. In ten or fifteen years the cost of central and local government in the United Kingdom has doubled, partly because of the South African war and increased expenditures for defence, but principally because of the lavish expenditure on education, municipal tramways, waterworks, lighting and on the housing of the poorer classes. So, too, the ordinary expenditure of the Dominion Government has increased from $42,975,000 in 1900 to $98,161,000 in 1912. In all civilized countries the state is appropriating an increasing part of the individual's income.

Now, so far as the State is giving increased value for this increased burden on the individual, the increase is not in itself an evil. If the State performs certain functions for the individual better and cheaper than a corporation could perform them, as in the case of the Post Office, the increase of State functions is a positive good. In fact the whole question of municipal and public ownership is a question of expediency in each individual case. Whether ownership is public or private the receipts of the enterprise come from the pocket of the individual citizen. If he gets more for less money under public ownership, then public ownership should be adopted. If not, it should not be adopted.

All Public Money Comes From the Individual.

All the public money, as we have said, comes from the pockets of the individual. How shall we decide how much of the individual's income the State may take? There is no logical limit to the State's demands; it may logically demand not only a man's property, but his life for its service (in Canada every man between 18 and 60, with a few exceptions, is liable to be called upon to serve in the defence of the country). But in practice we find that its demands upon the people of a country are regulated by the amount of money which those in authority find it necessary to expend in the public service.

So, then, we have one great difference between individual and State economy. The individual has to regulate his expenditure by his income; the State regulates its income more or less by its necessary expenditure. The individual says: "I can spend so much;" the Finance Minister, "I have to raise so much." As it is, therefore, the amount and kind of expenditure which determines the amount and kind of the revenue, we shall deal first with expenditure.

Expenditure—Defence.

The first duty of a Government is, says Adam Smith, the protection of its subjects from the violence and invasion of other independent societies. This is a duty which can be discharged only by the maintenance of a considerable body of armed men, and if the nation be a maritime one, it should keep up also a navy proportionate to its needs.

This is, no doubt, the greatest single item of expenditure among all world powers, and the cost of preparation for war, in these days of inventions, continues to increase with startling rapidity.

In 1914 the United Kingdom was spending about $400,000,000 per annum on its army and navy; the military and naval expenditure of the United States in 1913 was $288,000,000, besides $163,000,000 in pensions—a total of $453,000,000. Germany, apart from the extraordinary levy of $250,000,000 in 1913, spent $350,000,000, and France in 1913 $283,000,000 on her army and navy. Russia, Italy, Austria-Hungary and Japan are also groaning under the burden of armaments. Nor in spite of the efforts of statesmen to secure a limitation of armaments, does it appear that the end is yet reached.

Canada has so far got along with remarkably little expenditure in this direction—only about $16,000,000 at the present time. She has probably been wise in restricting her military expenditures hitherto, but it does not seem that she can do so for long. The enormous increase in military expenditure on the part of Japan and the United States, the new world-powers, makes it necessary for us to reconsider our position. As Great Britain cannot afford to keep a large fleet in the Pacific, it seems necessary that we should co-operate with Australia and New Zealand, which, like ourselves, are threatened by the advance of the yellow races, to maintain a squadron in the Pacific.

In respect of this first item of expense, therefore, it would appear that Canada's expenditure for defence is altogether inadequate, when we consider the magnitude of the interests and the rich and fertile territories which she has to defend. Thus far, at least, she is indebted to the Motherland for her protection.

Expenditure—Administration of Justice.

The second great function of the State is the maintenance of internal security, or in other words, the preservation of law and order, the necessity of which is admitted by all except advanced anarchists. All civilized people accept this as a necessary function of government.

This duty of the State necessarily involves considerable expense, and there has been a great deal of controversy as to how the money necessary for this purpose should be raised. In the Middle Ages it was raised by the fee system, that is by collecting high fees from all persons who resorted to the law courts for legal remedies. This system has at first sight much to recommend it. The public revenue is exempt from any charges; the persons who are presumed to gain have to pay for service rendered; the judges are stimulated to diligence by the hope of reward. So plausible is this idea that it was maintained by Adam Smith.

But it is now generally held that the judge's toil is not for the benefit of the particular suitors who appear before him, but for that of society at large. All private property is more valuable than it would be if there were no laws and judges to secure its enjoyment to its possessors. Therefore, all private property should pay for its protection. Furthermore, the fee system gives an immense advantage to the rich over the poor, and on this account alone it is objectionable. It seems proper, therefore, that the cost of the administration of justice and the maintenance of the police should be borne by the ordinary public revenues.

Expenditure—Administrative Supervision.

The third great division of the functions of Government is given the name of Administrative Supervision, that is, the maintenance of inspectors of mines, factories, shipping and food, etc.

Here we are on more debatable ground. Many of the laisser faire economists of the nineteenth century protest against all such supervision as an infringement of individual liberty. Their maxim was Caveat emptor, "let the purchaser look out for himself." But in these days of imitations and adulterations, when it is possible to produce artificially food stuffs so like the natural foods as to deceive any average individual, is it reasonable to expect that the ordinary man shall be able to detect these frauds? The civilized countries of the present day have generally agreed to answer this question in the negative. Modern public opinion demands that ignorant or unprincipled producers shall not be allowed to endanger public health by the sale of food products—especially meat and milk—which are unfit for human consumption. So too out of regard for the safety of its citizens the State insists on reasonable care in the operation of mines, the equipment of factories and the conduct of shipping. Possibly the work of factory inspection might be handed over to the Trades Unions, but in such a case it is unlikely that we should have uniform administration of the law, which is absolutely essential.

Expenditure—Poor Relief.

Poor relief is in most countries a charge on the public revenue. Why is it not left to individual charity as the laisser faire school recommended, instead of being made a compulsory charge on the public purse? The answer is (1) That private charity is too precarious and uncertain to be relied on for long periods of time; (2) That indiscriminate giving is likely to relieve the most persistent applicants rather than the most needy; (3) That private charity means a heavy burden on the more generous-minded and no burden at all on the niggardly; (4) that under our present penal system a destitute man may always secure the means of living by committing a crime. To deny to the pauper what is thus guaranteed to the criminal amounts to an inducement to crime.

The objections raised to State relief are :(1) that to give support to the non-worker is communistic; (2) that State relief demoralizes the receivers more than private charity; (3) that all relief discourages thrift. These arguments have great force, but not enough to invalidate the foregoing considerations. Practically all economists are agreed, however, that poor relief should be more carefully and discriminatingly applied. The events of the winters of 1907-8 and 1913-14 in Toronto and other Canadian cities show that in many ways poor relief can be more efficiently administered by the State than by private charity.

Expenditure—Education.

The recognition of education as one of the natural functions of the State, is partly due to the decline of the church, but still more to the rise of the modern spirit of democracy. It is agreed by all progressive nations that the State ought to provide an elementary education for all its children, that is, for its future citizens, because uneducated citizens are a great danger to any democratic community. Secondary education has, however, in Europe at least, been left very largely to private initiative or to voluntary effort. The same is the case with university education. Even in our own country where State education is dominant, many complain that its influence is too largely secular and too stifling to the individual character—that an individual who has passed through it is, as it were, the product of a machine. Consequently various religious denominations have built up secondary schools and universities of their own, where, they claim, more attention is paid to the individual and his needs than in the State institution. In spite of the fact that many hold this point of view, the balance of opinion is certainly in favour of regarding education as one of the main functions of the state.

Expenditure—Religion.

The maintenance of a national form of religion is still in many countries regarded as a proper object of public expenditure, but the support of religion is obviously becoming more and more a matter of voluntary effort. The disestablishment of the Church of Ireland in 1870 shows this strong tendency, as do also the proposals to disestablish the Church in Wales. In our own country we may regard the tax exemption given to all property owned by religious denominations as a species of establishment of religion in general.

Expenditure—Aiding of Industry.

One of the most important functions of government is the aiding of industry. This is performed in many ways: by maintaining a monetary system, a system of weights and measures, post offices and telegraphs, and in some countries government railways and steamship lines, and by the maintenance of a consular service. A more debateable method of aiding industry is by paying bounties on domestic production or levying protective import duties on commodities brought from abroad. Both of these, which are usually conceived to be temporary in their character, we have already considered under the subject of "International Trade."

Expenditure—Extraordinary.

We have now dealt with all the ordinary expenses of Government. But we know that any Government may at any moment be compelled to incur extraordinary expenditures, usually for the defence of the nation against its enemies. There have been no more peace-loving or economical governments in the history of the world than that of the younger Pitt before 1793, or that of Lord Aberdeen in 1854, when Gladstone was Chancellor of the Exchequer. But even these governments found themselves compelled to go to war and to incur enormous expenses in the defence of their country. These vast expenditures cannot be raised by taxation without disorganizing the whole financial system of the country and consequently Finance Ministers generally resort to loans for the purpose of carrying on war. They have usually judged it expedient, however, as did Mr. Gladstone, to make the people feel the cost of the war by imposing heavy war taxes at the time—a measure which has had a very good influence in abating the jingoism of the people, and is entirely commendable from a financial point of view.

Division of Functions Between Central and Local Government.

Up to the present, nothing has been said of the division of duties between the central and the local government. All public expenditures are really one in kind and it is impossible to draw a precise and definite line between central and local expenditure. For instance, our provincial and municipal governing bodies take part in supporting the state system of education, and our Dominion and Provincial Cabinets have each a Minister of Agriculture. There is no theoretical reason from a financial point of view, why all the municipalities of Canada should not be ruled from Ottawa as Napoleon ruled all France from Paris and Frederick the Great decided the minutest affairs of a Prussian town from Berlin. But in practice our Anglo-Saxon ideas of self-government have resulted in the adoption of the working principle that each community shall manage its own local affairs. What precisely are ''local affairs'' is somewhat difficult to determine and the distinction is usually made by a somewhat arbitrary rule. For instance, in rural communities, bridges over a certain length are built and maintained by the county and shorter ones by the townships. In Canada the line of division of powers between our Provincial and Dominion Governments was practically decided at the time of confederation by the necessity of leaving to Quebec those political and religious institutions which were peculiar to the French-Canadians. But these are political considerations having nothing to do with our subject. We must repeat, then, our conviction that there is, from a financial point of view, no definite division between the functions of local and central government.

Revenue—''Economic'' and Tax Revenue.

After dealing with the expenditure of the State, we turn naturally to consider how the revenue necessary to meet this expenditure ought to be raised.

The revenues of the State are of two main kinds: (1) There is the revenue which is obtained by the State in its various functions as a great corporation or legal "person" operating under the ordinary conditions that govern individuals and companies; (2) that taken by the sovereign from the subjects by taxation. To the former class belong the rents received by the State as landlord, the interest on its investments, and the earnings of its great services such as the Post Office. In the second class have to be placed all taxes of whatever kind.

Classes of "Economic" Revenue.

It is with the former class—the "economic" receipts of the State—that we shall be concerned in this lesson. These may be divided into three classes. First, we all know that the State may be landlord and receive a rent from its tenants for the use of land or of other natural resources. Secondly, the State may be a Capitalist, when, for instance, it lends funds to municipalities or to corporations (as in the Sault Ste. Marie loan of $2,000,000) and receives interest therefor. Thirdly, the State may be an Entrepreneur, an undertaker of industrial enterprises, and may receive a profit from them over and above any rent and interest charges. The State operates the post office in practically all countries, the telegraph and telephone lines in Great Britain and various other countries, and the railways in Prussia, Australia, Russia, British India and other countries. We will consider briefly these classes of "economic" receipts.

I. The State as Landlord.

The public domain—the ager publicus of the Romans—was throughout ancient and mediaeval times regarded as the basis of public income. The feudal king was the greatest, and indeed in the case of William the Conqueror, the only landowner in his dominions. All men held their land from him on condition of military service and rents in kind or in money; hence land rent in his day constituted the main revenue of the State. In time, many land-owners redeemed their land tax by paying a lump sum; others still pay the tax, which, though now insignificant in amount, is a recognition of the State's part-ownership of the land. In France the State lands were greatly reduced in extent at the time of the Revolution. Prussia and the other German States, Austria and Russia still possess considerable amounts of State land which is largely in forest. By the practice of scientific forestry, Prussia derives a net revenue of $15,000,000 and Bavaria of $10,000,000 per annum.

In the newer countries, the United States, Canada, and Australia, it has been found that the very best way to attract immigrants is to allow free access to the land. The immigrant coming into our own North-West, pays only $10 for his quarter-section, an amount which would not cover the cost of surveying it and keeping open the land offices. But it is felt that the stimulus given to production and improvement in this way offsets any advantage which the State might derive from merely leasing the land to the immigrant and charging him a rent which would increase with the development of the district. The immigrant who becomes an owner rather than a renter is more likely to be a permanent and valuable citizen, and the income derived from him by the State in the form of taxes is likely to be quite as great as that which would have been derived in the form of rent.

The apparent advantages of a large state revenue derived from land and the peculiar nature of the income—the rent received for the use of it—have suggested the advisability of dispossessing private owners, either with or without compensation, and reverting to the single or land tax. But such a project, if it were carried out, would result in a widespread feeling of insecurity. Compensation would be practically impossible, and confiscation without compensation would lead to revolution. (See also Lesson XI.)

State Ownership of Forests.

Adam Smith strongly condemned state property because it was badly managed and recommended the sale of it to meet extraordinary expenses only, not ordinary expenses, which should be met from current taxation—a rule which in Canada is more honoured in the breach than in the observance. Only in one case, that of forests, must we make an exception to this rule. The individual farmer does not love the forest. He can hardly hope to reap in his own lifetime the benefits of creating it, and has no conception of the important natural advantages which accrue to a country that preserves its forests. There is practically a consensus of competent opinion in favour of state action for the purpose of increasing the areas under trees, and directly administering these areas by a skilled and well-organized staff.

II. The State as Capitalist.

The business of banking is in so many ways connected with the State, that the public management of banks appears to have much to recommend it. The ordinary method has, however, been that of granting concessions to privileged companies which are bound to afford facilities to the State in return for the advantages which they enjoy. England, France and Germany adopt this policy, and the pure "State-bank," where the capital of the undertaking is supplied from the State funds, is found only in Russia and Sweden. The Post Office Savings Bank is another instance of State action along this line. The chief reason for its establishment is that it affords an absolute security to innumerable persons of the poorer classes who would otherwise be often victimized by untrustworthy institutions. The great process by which Irish land is at the present time being transferred from the landlords to the peasants by the use of the State's credit, is another instance of the State acting as a Capitalist.

The great advantage which is derived from the State's action as a capitalist, is security; this is seen in the case of the Post Office Savings Bank and the Dominion Government Annuities. The great disadvantage is that State advances to individuals are likely to become an object of political wire-pulling and certain individuals or classes may be favoured at the expense of others. It is for instance very questionable whether the Irish peasants will ever be called upon to repay to the State all the money advanced them to pay off their landlords. Some government may find it worth its while to remit these payments —or part of them—in return for the political support which such action would gain them in Ireland. While in this particular case the good accomplished might as a matter of general policy justify the expenditure, this instance illustrates the danger of possible unfairness in the action of the State as Capitalist.*

III. The State as Entrepreneur.

This is a much wider field of State action than either of the preceding. In several States the Government owns and works a number of mines—for instance, Prussia, which in 1902 derived $43,000,000 revenue from this source.

The modern State, however, has not confined its activity to extractive industries. In almost all countries it has gone in for manufacturing, especially for the manufacturing of the articles needed to supply its own military and naval needs. This is defended on the ground that it is the only way of guaranteeing the goodness of the arms or clothing on which depend the lives of the soldiers.

Desirability of State Operation of Industries.

In fact, the whole question of whether a State should undertake industrial functions must be answered thus: there is always a presumption in favour of private ownership as being more economical and businesslike, but this general principle cannot be considered as in itself conclusive and must be abandoned when it is shown that the interests of the community will be furthered by governmental action.

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*One of the best examples of the State deriving a revenue from investments is the United Kingdom's revenue from Suez Canal shares. These were purchased not for financial but for political reasons—in order to acquire control of the shortest route to India. However, they have turned out a splendid investment, and, besides paying excellent dividends, could now be sold for far more than was paid for them. The Dominion's interest on its investments was, in the fiscal year 1912, $1,281,000.

In what industries is it possible that the interests of the community might be furthered by government action? First, in the case of those industries in which there is a natural tendency to the creation of monopoly; second, in those industries which deal with communication and transportation.

Municipal Operation of Public Utilities.

The first class of these industries, i.e., those which are likely to become monopolies, fall mainly within the domain of local rather than that of central government. Perhaps the most important of them is the supply of water, which has of late years tended to become a municipal enterprise throughout the civilized world. Only three English cities still have private water companies and only forty-four out of one hundred and thirty-five cities in the United States. The public ownership of lighting plants is also very general and tends every year to become more popular. This is well illustrated by the widespread adoption of the power applied by the Hydro-Electric Commission for lighting and manufactures in the Province of Ontario.

State Operation of Post Office, Telegraphs and Telephones.

The second group of industries—those dealing with communication and transportation—includes the best known and most generally accepted of all State employments, the Post Office. Even Adam Smith regards it as an exception to his rule of the inexpediency of State action in the field of industrial enterprise, and declares that it is the only mercantile project which has been successfully managed by every form of government. The general principle which has governed its operation is that of supplying the means of communication at the lowest possible rate to all the citizens of the State. The United Kingdom, however, derives a net revenue of $20,000,000 and Germany of $10,000,000 from their post offices.

Along with the post office come the allied telegraph and telephone industries, which have been much less successful under public ownership. The British telegraph rate—twelve words for sixpence to any place in the British Isles—has not proved sufficient to meet the cost of the very efficient service, but public opinion seems opposed to an increase of the charge. The British telephone system, originally in private hands, has recently been taken over by the State; here neither private company nor State management have, so far as can be learned, proved satisfactory.

State Operation of Railways.

The most important subject, under this head, and that which has given rise to most controversy, is the public ownership of railways. The United Kingdom and the United States have agreed to consider railways as merely a particular form of industry like banks, shipping, mining, dependent for their special privileges on the direct act of the legislative power. The continental countries of Europe have, on the other hand, recognized a much closer connection between the State and the railways. France has the reversion of her railways, most of which will become State property between 1950 and 1960; Prussia owns and operates 90% of hers, deriving a net revenue of about $75,000,000 thereby. Austria and Russia also receive large surpluses from their Government railways. The Scandinavian countries too have adopted State ownership of railways with indifferent success from a financial point of view. The experiment in this line which interests us most is the State ownership of the railways in Australia and New Zealand. In Australia the railway returns of the various States for the year ending June 30, 1910, show a surplus of receipts over working expenses of $30,000,000, which constitutes a fair interest rate of slightly over 4% on the cost of construction and equipment, $730,000,000.

This would probably cover the interest on the capital borrowed from Great Britain for building and equipping the lines, and it may reasonably be expected, that the growth of population will in future largely increase the railway receipts in all these colonies without proportionally raising the working expenses. The passenger rates, for such a new country, are exceedingly low, averaging 1½ cents per mile. On the Victoria lines at least students are carried in and out from the Melbourne University free. All these railroads are under the management of expert commissions.

On the whole, the conclusion, from a purely financial point of view, is against state ownership of railways, but so many considerations of development and unity of management and, most important of all, of public service, come into the question, that it is impossible to pronounce a general verdict one way or the other. One thing, however, our experience with the Intercolonial and the example of Australia have taught us: If government ownership is to be a success, the details of railroad management must be left in the hands of a non-partisan commission of railway experts.

Municipal Street Cars.

What the railway system is to the nation, the street railway is to the city or town, and it is quite in accordance with the general trend of events that there should be an attempt to municipalize these means of communication. A large number of British cities own their street railways, but in many of these cases the lines are leased to companies. In the United States only a small number of cities own their street car lines, though the number is growing. In Canada, many of our smaller cities, such as Guelph and St. Thomas, own their street cars, but the experiment is too recent to warrant any very definite conclusions.

Note.—The student must bear in mind that public ownership tends to swell the revenues, the expenditure and the debt of the state. Therefore, in comparing the finances of countries which own their public services and those which do not own them, we must always make the necessary deductions from the accounts of the former, as, for example, in a comparison of Australia and Canada. The debt of Australia is over $1,000,000,000, and ours in 1912 was only $340,000,000, but Australia's railways are probably worth the difference.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XIX.

1. What was Adam Smith's idea of the proper functions of Government? How far do we differ from him and why?

2. What are the chief differences between state and individual finance? Discuss.

3. What is the justification for taxing the citizens to provide defence? Outline the present position of Canada with regard to this question.

4. What have been the principal ideas as to who should pay for the administration of justice? What is your idea?

5. What is meant by administrative supervision? How do you account for its growth in the past generation?

6. What are the arguments for and against state expenditure on charity? On education?

7. What are the main functions of the Dominion, Provincial and Municipal Governments? Can you draw a clear line between them?

8. What are the three classes of Economic Revenue? How do they arise?
9. What do you think of state ownership of land? Where is it most approved, and why?
10. Write a note on "The State as Capitalist." Ought the Western Provinces to borrow money in order to make loans to farmers at a cheaper rate than the farmers would otherwise have to pay?
11. Why are all nations operating the post office as a government department?
12. How far are the arguments applied to the post office applicable to government operation of railways and municipal operation of street railways?

ECONOMICS

LESSON 20

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ECONOMICS

LESSON XX.

Public Finance—Part II.

IN the last lesson we discussed economic revenues—those derived from the action of the State as landlord, capitalist or entrepreneur. These economic revenues, however, constitute but a mere fraction of the total revenue of most countries. Furthermore, they are generally derived from some service performed by the State for the citizens and so imply an expenditure which is usually almost as great as the revenue. Indeed, in most countries there is a strong prejudice against the State exacting from a public service more than is sufficient to meet the cost of it. If any of our public services had a surplus, we should probably agitate for a lowering of rates; then the State would cease to derive any net money advantage from running such services. No matter what are the gross receipts, the treasury will not benefit if there are equally large expenditures. Hence the net economic revenue is usually small—in the United Kingdom only 6% of the total revenue.

Bulk of Revenue Raised By Taxes.

In almost all countries, then, the bulk of the revenue must be raised by the imposition of taxes. What is a tax? Bastable defines it as "A compulsory contribution of the wealth of a person or body of persons for the service of the public powers." It is "compulsory," not because it is necessarily paid unwillingly, but because the will of the payer is legally immaterial. It is a "contribution" because it involves a sacrifice, a deduction from the wealth of the taxpayer. It is levied for "the public powers," i.e., either central or local government, for the smallest village as for the Dominion or the Empire.

Taxes Direct or Indirect.

Taxes are generally classified as being either direct or indirect. A direct tax, as ordinarily defined, is one which is levied upon the person who is expected to bear the burden of it himself; an indirect tax is one whose burden is intended to be shifted upon someone else than the person who actually pays it. An income tax is generally of the former class. The man against whom it is charged is expected to pay it at his own loss. A customs duty belongs to the latter class. The importer pays it to the government; but it is expected that he will charge the greater part if not the whole of it to the man who buys the article, so that the tax will ultimately be paid by the consumer instead of the importer.

Taxes Are a Burden on the Taxpayer.

As we have already seen, taxation, whether direct or indirect, implies a deduction of wealth from the individual and is therefore an evil. It may be necessary and advisable, but after all it is only a necessary and advisable evil to avoid greater evils. Those who say that government expenditure is in itself a good thing because it gives employment and benefits the labourers, forget that if the money expended had been left in the pockets of the taxpayers, it would probably have given employment to even more labourers, because a certain amount of it has gone into the hands of the Government and must be deducted for expenses of collection, which in most countries is no inconsiderable item. For example, in the fiscal year 1912 it cost us about $3,200,000 to collect a tax revenue of $106,847,000. It is one of the most generally recognized maxims of finance that "Every tax ought to be so contrived as to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State."

The cost of collection should, therefore, be as small as possible; taxation should also be so arranged as to cause the least possible obstruction of industry. The latter point may be illustrated by reference to a seventeenth century Spanish tax of 10% on the price of an article every time it was sold. If an article were sold by a manufacturer for $12.00, the seller would have to pay a tax of $1.20. Suppose that the article were again sold by the wholesaler at say $15.00, $1.50 more would be given to the State. If the article were sold a third time by the retailer, say at $20.00, another tax of $2.00 would be levied—a total tax of $4.70 or nearly 40 per cent. of the manufacturer's price. It is evident that such a tax would have a very disastrous effect on trade, and it doubtless contributed in a considerable degree to the economic ruin of Spain. If we laid a heavy duty on the Pennsylvania coal which comes in to supply our manufacturers with power, we should be doing something of the same kind.

Who Should Pay Taxes?

Who should pay taxes, and how much should each man pay? This is the next question which we have to consider—a question which is very hard to settle. Extreme individualists say that taxation is the price of State services, and that each citizen should pay according to the benefit which he receives. But does not the poor man receive as much benefit, as much protection, from the State as the rich man? Apparently, then, he should pay as much for it, just as the poor members of a club have to pay the same fees as the rich. But such a thing is impossible. If we divided up the Dominion Government's taxes equally, each family would pay about $70 a year. This would be perhaps 20% of the agricultural labourer's whole income, while it would be a mere trifle to a millionaire. Clearly, then, this theory is politically impossible and extremely unjust.

Proportional Taxation.

A much more popular theory of taxation was advanced by Adam Smith and John Stuart Mill: "Equality of taxation as a maxim of politics means equality of sacrifice."

That is, according to Mill's interpretation of this theory, a man should pay taxes in proportion to his annual income. For example, the net revenue of the Dominion is about 5% of the annual income of its people. Each citizen would, under Mill's system, pay 5% of his income into the National Treasury. Thus, a man with an income of $500 a year would pay $25 in taxes, while a man with $50,000 a year would pay $2,500 in taxes. It is assumed that the loss of $25 means approximately the same sacrifice to the man with $500 as the $2,500 means to the man with $50,000. But this is quite a mistaken idea. To the man with a family and an income of $500 a year, the loss of $25 may mean the doing without necessary food or education. To the man with $50,000 a year, the loss of $2,500 may mean doing without a steam yacht.

In most countries, therefore, it has been decided to exempt from taxation an income which is barely sufficient to afford subsistence. In Britain, for instance, incomes under $800 are exempt from income tax, though such incomes bear some indirect taxation on liquors, tobacco, tea, coffee, etc. In Prussia a poorer country, incomes under $225 are exempt from income tax. Among ourselves, also, incomes of less than certain specified amounts are exempt from the municipal income tax. The exemption is higher ($1,000 in Toronto as against $600) for married men than for single, on the assumption that it necessarily costs the married man more to live. It seems, then, to be practically universally accepted that it is a mistake to impose taxation which cuts into the necessary income required by the citizen to live on a decent scale and to bring up his family. By reducing the industrial efficiency of such a citizen and his children, the State loses more than it can gain by taxing him.

Progressive Taxation.

A much more doubtful theory is that of progressive taxation, which is supported on the ground that equality of sacrifice is not attained by proportional taxation, but that the richer a man is, the less he will feel the deduction of a certain percentage from his income. Therefore, in order that he may undergo an equal sacrifice with the poorer man, we must take from his income a larger percentage. Progressive taxation, therefore, includes any system in which the rate of taxation becomes higher or progresses as income increases. It is claimed, for instance, that even 20% would not be too much for the nation to take from a man with an income of $50,000 a year. He would pay $10,000 in taxes instead of $2,500, and various poorer families would be relieved $7,500, which they now have to pay, the loss of which costs them much more sacrifice than it would cost the millionaire.

United States Income Tax Progressive.

Many economists such as Seligman, Devas, and Nicholson, say that there is no objection to moderately progressive taxation. A good example of such taxation is the Federal Income Tax of the United States, which became law in 1913. Under this Act, married persons with over $4,000 and single persons with over $3,000 a year are subject to tax on so much of their income as exceeds these amounts. The measure is complicated, but two or three specific instances will serve as illustrations: ,

A married man with $10,000 a year pays $60 or 3/5% of his income.

A married man with $100,000 a year pays $2,510 or 2½% of his income.

A married man with $250,000 a year pays $10,010 or 4% of his income.

A married man with $1,000,000 a year pays $60,010 or 6% of his income.

In these democratic days, this principle is becoming increasingly popular, but it is entirely arbitrary and therefore very dangerous. There can be no fixed limit to progressive taxation if the principle is once adopted. There is no assignable reason why a man worth $100,000 a year might not be taxed 99% of his income. The admission of the principle leaves the way open for such taxation of the rich as would amount to confiscation. Such a tax would often be impossible of collection on account of the difficulty of knowing what a wealthy person's income really is. It would also discourage the accumulation of wealth and thus injure the State as a whole.

Progressive taxation, unless collected at ruinous rates, would not bring enormous sums into the treasury, because very large incomes in any country are comparatively few and do not constitute a very large proportion of the total national income.

Earned and Unearned Incomes.

Another important question which was much discussed in England some years ago is "Shall a man who earns $1,500 a year by his personal labour be taxed at the same rate as a man who receives that amount as an income from property—unearned income?" The English for a long time answered this question in the affirmative, though John Stuart Mill as early as 1852 expressed himself as convinced of the injustice of taxing, equally heavily, earned and unearned incomes. The man who is living on his earnings, Mill claimed, has to save money or insure his life to provide for his wife and family or for his own old age. The man who gets his $1,500 a year from property may spend his whole income, in the knowledge that his property will provide for his wife and children after he is dead. This plea led Parliament to remit the tax on all moneys paid as life insurance premiums up to 1/6 of a man's income—$250 out of a $1,500 income. This system lasted for over fifty years; in 1907 it was succeeded by an arrangement more favourable to the earned income. Where the total earned income is not over $10,000, it is taxed at only 3/4 the rate of unearned income—a measure whose justice is undeniable, inasmuch as the average man who is entirely dependent on what he earns, will need to save at least a quarter of it for old age or for his family.

Conclusion Regarding System of Taxation.

On the whole, then, economists have come to the conclusion that proportional or slightly progressive taxation, exempting the necessary living income and making a fair allowance for the necessary savings in the case of an earned income, is the best way of distributing the income tax. The same general principle applies to the sum total of taxation.

Division of Taxes Between Central and Local Governments.

Especially in a federal country like our own we have the question of how the proceeds of taxation should be divided between central and local governments—between federal and provincial and between provincial and municipal governments. In all federations, as a matter of practice, indirect taxation has been allotted to the national or federal, and direct taxation to the provincial (or state) and municipal governments.

Indirect taxation, consisting mainly of customs and excise duties, naturally goes to the federal government, which is necessarily in charge of the tariff policy of the country, which must be uniform throughout the whole area. Direct taxation, including income and property taxes (some would also include succession duties under this head) must, therefore, be left as a source of revenue for provincial and municipal governments.*

What Particular Taxes Are to Be Levied?

We have now decided approximately how much we should levy and from whom we should levy it. The next question is, what is to be our general system of taxation? What taxes are we to use? One income tax? A few taxes or many taxes? The first is too easily evaded and too apt to arouse what has been called "the ignorant impatience of taxation." However, it is a good tax to use in part, and it usually costs little to collect. Then it should be supplemented by moderate, indirect taxation—taxation directed as much as possible against spirits, tobacco and other luxuries which no one actually needs to consume. If a citizen pays taxes by consuming these articles, he has only himself to blame. Indirect taxes are disguised and do not irritate the contributor; they are productive and in times of prosperity the amount raised increases rapidly, and thus provides for the increased needs of the State. On the other hand, the rule of equality of taxation is frequently violated. The rich man in England who does not drink or smoke pays very little in indirect taxes. Indirect taxes may possibly give stationary or even diminished receipts in hard times. Reliance on indirect taxation alone will sooner or later cause financial embarrassment.*

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*See British North America Act, Sections 91 and 92.

For example, take the United States or Canada. In good years we have huge surpluses, which lead us to spend recklessly, as in the case of the enormous American expenditure for pensions. In bad years we have large deficits. If we raised half our revenue as the United Kingdom does by direct taxation, we could put another cent on the income tax in bad times and take it off in good times.

Hence the principle of levying about equal direct and indirect taxation, which has been adopted in the United Kingdom, is on the whole more scientific and economical than our own system of duties. We must remember, however, that our tariff and the American tariff, unlike the simple English tariff, were not adopted for purely financial but rather for protective purposes. They served a special function for new countries.

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*The question of indirect taxation is extremely complicated. Such taxation is, when protective, likely to be either consciously or unconsciously unjust, and the government levying it is usually open to the accusation of legislating in favour of a special class or a certain locality. The Southern States, for instance, used to claim that the protective tariff of the United States worked to benefit the Northern manufacturing States, and to impoverish the Southern agricultural communities. Our own Western provinces are at the present time raising the very same cry against the East. No doubt, manufactures will eventually develop there as they have developed in the Southern States, and then the cry will cease.

Conditions of a Good Tax.

Four main conditions of a good tax have been laid down by Adam Smith, the essence of which may be stated in four words: Equality, certainty, convenience and economy.

Equality—in proportion to the individual's ability to pay.

Certainty—amount, time and manner of payment ought to be made clear to everyone.

Convenience—tax ought to be paid at the time when it is most convenient to the taxpayer to pay it.

Economy—costs of collection should be as small as possible.

Some modern writers have declared that these conditions are mere truisms, but in the system of finance of Adam Smith's time they were certainly not truisms. The English system of taxation in those days was very bad, taking far too much from the poorer classes. The French system was execrable and played no small part in bringing about the great French Revolution.

In laying down these rules, however, Adam Smith looked at the question purely from the taxpayer's point of view, as was natural to his individualistic mind. It is quite possible to imagine a system of taxation which should conform to all his canons and still be quite inadequate to the service of the State. Modern writers, therefore, have added two other canons to his four: productivity and elasticity. Productivity implies that no tax should be imposed which does not bring a substantial amount into the public treasury; elasticity, that the system should be so flexible that it will be possible to provide for the needs of the country in hard times and to dispense with unnecessary taxes in prosperity. This requirement is met in the English tax system by the flexibility of the income tax.

No Flexible Tax in Canada.

In Canada and the United States there is no flexible tax corresponding to the British income tax; the amount raised by customs and excise duties in a given year is determined, not by the necessities of the Government, but by the state of trade. If trade is poor the return from these taxes declines, although the expenses of government may have increased. Our revenue is thus at times much less than our expenditure, while at other times it may be in excess. Of course, the tariff may be raised or lowered, but this is rarely done on fiscal grounds alone, and, even if done, may not produce the desired result.

Succession Duties.

In our Provinces, one of the principal sources of income is the succession duties, which were adopted as a revenue-raising device some years ago. It is claimed that they put an unjustly heavy burden upon the wealthy and that by reason of a series of deaths they may be levied upon one property four or five times in a generation, while they are levied only once on another similar property. However, as we have no income tax, other than the municipal income tax, succession duties tend to prevent our system of indirect taxation from unduly favouring the rich, and they have the great advantage of taking taxes from no one in particular. The heirs to an estate, who are receiving a large amount, are not very likely to grumble at paying a small percentage into the treasury. They must remember that it is the State whichguarantees their succession, and that the State may reasonably charge a fee for so doing. There have, of course, been many more or less successful attempts to evade the death duties by conveying property to one's heirs in one's lifetime. These, however, are likely to become less frequent as the principle of succession duties becomes more generally accepted among us, and the loopholes in the law are gradually stopped up by amendments.

Municipal Taxes.

The kind of taxation which weighs most heavily upon the average Canadian and which also secures to him the greatest benefits is municipal taxation. This is usually direct taxation levied upon the persons who are intended to bear it and who derive the most profit from it.

The Real Property Tax.

The chief source of municipal tax revenue (as distinguished from municipal economic revenue) throughout the Dominion is the tax upon real estate—land, houses, etc. In some Western cities improvements are taxed not at all or at a lower rate than land values. Thus in British Columbia, under the Municipal Clauses Act of 1906, improvements may not be assessed at more than 50% of their actual value. They may even be exempted from taxation altogether; in Vancouver since 1910 improvements have been exempted from taxation. So too in Alberta. Edmonton has not taxed improvements at all since 1904 and Calgary decided in 1912 to reduce the assessment on buildings to 25% of their actual value. The system of exemption of improvements has proved successful enough during a period of great growth and prosperity; whether it will be possible for the Western cities to pass through a period of depression and shrinking land values without reverting to the taxation of improvements, is still in doubt.

In Ontario and other Eastern provinces there is no such exemption of improvements, although the Liberals in the Ontario Legislature have put themselves on record as in favour of allowing municipalities to decide as to whether they will exempt improvements or not—local option in taxation. In all the Eastern provinces, real property is understood to be assessed at its actual cash value. The total value of property in the rural municipality, town, or city, is thus arrived at, and as the amount required for the current expenses of the public service is approximately known, it is possible to estimate how many mills on the dollar of assessed property will raise the required sum. Taxation in most Canadian cities averages about twenty mills or two cents on the dollar of assessed property.

If we consider the real estate tax from the point of view of our canons of taxation, we shall see that it has the merit of elasticity, since the rate can be varied to meet the varying requirements of the municipal revenue; it is fairly conomical in cost of collection and reasonably certain and convenient in the manner of collection. In agricultural districts, villages and small towns it may be fairly equal—that is, the amount that a person pays may be approximately proportionate to his income, since in such localities almost the entire income of the people is derived from their real estate and is usually proportionate to the amount of real estate which they hold.

Defects of the Real Property Tax.

The tax on real estate alone, however, ceases to have the advantage of equality when it is applied to a modern city where a large part of the income of the citizens comes from stocks and bonds about which the municipal assessor knows nothing whatever. The incomes of citizens, not being necessarily drawn from houses and lands, may be very disproportionate to their assessment, and the amount of taxes which they pay will, therefore, not be in proportion to their incomes. For it must be understood that even the property tax is in the long run levied upon income. Indeed, this is the case with all taxes, with the possible exception of the succession duties, which cause a diminution in accumulated possessions rather than in income.

The real property tax is also unequal in levying a lower percentage upon the rich man than upon the poor. This is because the assessment is based on the selling value rather than on the cost of a property. While a poor man's house is easily saleable and has no expensive idiosyncrasies about it, a rich man's house is often built in such a way that no one could be found to buy it at anything like its cost. This leads to an assessment far below the cost, although the cost itself probably does not bear a higher proportion to the rich man's income than the cost of the poor man's house bears to his. The property tax is, therefore, defective.

Municipal Income Tax.

In order to make up for the defects of the property tax, we have the municipal income tax at so many mills on the dollar of income with an exemption of smaller incomes. This tax is levied at the same rate as the tax on real estate, and thus usually amounts to something like two per cent. of income after the exemption has been deducted. In Toronto the exempted income is $600 for single men, $1,000 for married men, and $1,500 for ratepaying householders.

The tax looks fair enough. The difficulty with it, however, is great, arising from the simple facts that the average man cannot be trusted to make an honest declaration of his income and that the government of so small an area as a municipality has not power sufficient to do what the British Government does, stop the income tax at the source of the income. This means that when a man owns a stock or bond in England, the corporation when paying him his profits or his interest, deducts the percentage of his income due in income tax and pays it to the Government. So too, an employer paying a salary over the exempted amount, deducts the income tax from the salary and pays it to the Government. Three quarters of the British income tax can thus be collected without possibility of evasion. The rest is collected on declarations. But no mere municipality has power enough to force corporations to do this, so evasion is much more likely to occur in Canada than in England.

It is possible, under our system, for the municipality to find out how much income a salaried man is receiving, but it is quite impossible to know what is the income of a doctor or a lawyer or what is the outcome derived by an individual from stocks and bonds. Thus the municipal income tax, while quite fair in theory, does in fact discriminate against the man who is receiving a fixed salary, and it is, therefore, far from being a perfect tax. Conceivably it might be collected at the source by Federal or Provincial Governments and turned over to the municipalities. But there would be great difficulties in arranging for the fair distribution of such revenue. The central government might well appropriate the tax and in return take over certain work now done by municipalities.*

Public Debts.

Under normal conditions, as we have already stated, our ordinary budget ought to show neither a surplus nor a deficit. A surplus shows that more is being taken out of the people's pockets than is required for the public service; a deficit, that too little is being received by the State to meet its necessary expenses. But as there are always some supplementary and unforeseen expenditures, it is usually the custom to prepare the estimates and impose or remit taxation so as to secure a moderate surplus.

The War Reserve.

In war time, however, we have noticed that it becomes quite impossible to meet the State's expenses by taxation within the year. Therefore, the State must either have money saved up for war purposes, or it must be able to borrow easily the money it needs. Russia and Germany have adopted the system of hoarding up treasure for an emergency; the latter country has $160,000,000 immediately available in bullion.

Government Loans.

Such a method of procedure, however, indicates that the country's credit is poor, and is moreover economically wasteful, as the country loses the interest which this money might earn if invested. Other civilized nations have preferred to borrow money for war on the State's promise to pay. Hence it is extremely important to all these States that their credit should be good, in order that they may be able to raise money readily in an emergency. The State which once breaks faith with its creditors will have great difficulty in raising any money thereafter, and may well be crushed by its enemies on account of its inability to raise funds. This consideration makes all civilized governments anxious to keep faith with their creditors, although, of course, there is no court which can compel them to do so.

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*There are, of course, many other taxes of various kinds—too many to be dealt with here. I have endeavoured to deal with only the most important taxes, which are the centres of present-day controversy.

The British National Debt Due to Wars.

In all old countries the debts are primarily due to wars. The growth of the British National debt will illustrate this fact. In 1689 it was only £1,000,000. By the end of King William III's reign it had grown to £16,000,000 and at the close of the war of the Spanish Succession, it reached £53,000,000. At the Treaty of Aix-la-Chapelle in 1748 it was £78,000,000 and the Seven Years' War increased it to £136,000,000. Another £100,000,000 was added by the American Revolutionary War, and the Twenty Years' War with the French brought up the English debt to £900,000,000 which was reduced to £800,000,000 in 1854. The Crimean War added £36,000,000, but by 1899 the debt had decreased to £628,000,000. In 1903, however, as a consequence of the South African War, the debt had risen to £770,000,000, reduced to £675,000,000 in 1912.

France's debt is the largest in the world—about $6,500,000,000—involving an annual interest charge of $250,000,000. The Franco-Prussian war contributed $2,000,000,000 to this amount, and the immense fortifications erected by the French on their eastern frontier have cost at least $1,000,000,000 more.

The American debt, which stood at $2,765,000,000 at the close of the Civil War, was in 1902 reduced to $937,000,000. In 1911 owing to the cost of building the Panama Canal it had increased to $1,348,000,000.

Debts of New Countries Due to Development.

Our newer countries, however, have contracted considerable debts, not for wars, but for the building of railways, canals, and for the improvement of transportation generally. Of our net national debt, which was $340,000,000 in 1912, $205,000,000 had been spent on our system of transportation—for Government canals and railways, besides $154,000,000 for Government aid to private railways. Thus our total net debt is less than the amount which the public has expended on the improvement of our transportation system.

Of Australia almost as much may be said. Of its total debt of $1,360,000,000, government owned railways alone account for $730,000,000. The Indian debt of $825,000,000 is also very largely a debt incurred for railways, reservoirs, and such other remunerative investments. In fact, in a young nation, where the people are poor, it is only the Government that can borrow the enormous sums needed for developing the country.

English Method of Paying Off Debt.

A State should generally aim at paying off its public debt in ordinary times. The English method of doing this, which is probably the best, is by setting apart an annual sum of at present £24,500,000 for the debt service. About £17,000,000 of this amount goes for interest and the other £7,500,000 is expended in buying up and retiring Government bonds. As the debt is reduced the amount necessary to meet the interest decreases, and that which can be used for paying off principal increases.

Conversion of Debt.

Another mode of lightening the pressure of debt upon a country is called "converting" the debt. Suppose, for instance that Canada had borrowed $50,000,000 in London thirty years ago when the average rate of interest was, say 5%, we would have had to pay $2,500,000 annually in interest. Then suppose that money became cheaper in the London market, and was worth only 4%. When the principal fell due, we could go to those who held our bonds and tell them that if they did not accept 4% instead of 5% we would pay them the principal, raising a new loan for this purpose. In time we might "convert" this $50,000,000 at 4% to 3½% or 3% stock by watching the time for a favourable money market. Naturally, if we tried to float such a loan at a reduced rate when money was in keen demand, we should be unable to do so, and should lose money on the deal, besides giving a shock to our national credit, both public and private, which would be of the gravest national concern, as may be gathered from the simple fact that in 1913 we borrowed $280,000,000 (including public and corporation borrowings) in foreign money markets. Nearly all loans now contain a guarantee that no conversion will be attempted for a certain number of years.

CONCLUSION

We have now arrived at the end of our course. The writer does not wish to claim for his treatment of the subject final authority, nor does he profess to have initiated the student into the deepest mysteries of the science, many of which are still a matter of the keenest controversy among expert economists who are devoting their whole lives to Political Economy or more often to some particular aspect of it.

He does believe, however, that the course constitutes a simple and direct statement of the leading doctrines of the subject, illustrated from Canadian sources and based upon Canadian conditions—a union of the concrete and national with the abstract and universal, which will give the best results, particularly in the case of the student who is not already trained in the difficult art of abstract thinking. He trusts that the students who have passed through the course will have acquired not only a knowledge of but an abiding interest in the great principles which govern economic life, as well as the ability to apply these principles in the actual problems of business.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XX.

1. Why are "economic" revenues usually comparatively unimportant?
2. Define a "tax." How are taxes classified, and what is implied by the classification adopted?
3. What is meant by Proportional Taxation? Should it be enforced on all citizens alike?
4. What is Progressive Taxation? Give an example.
5. Why, under the British income tax, are earned incomes taxed at a lower rate than unearned?
6. How are taxes in Canada divided between the Federal and Provincial Governments?
7. What general system of taxation is usually considered the best?
8. What are the conditions of a good tax, according to Adam Smith? What further conditions have been added by more recent writers?
9. What are the chief objections to customs duties as the main source of revenue?
10. What is meant by "succession duties"? Discuss their advisability.
11. Describe the real property tax. Why do the Western provinces tend to favour the exemption of improvements from taxation?
12. Describe the municipal income tax. Why was it introduced, and what are its chief defects?
13. What is meant by a public debt? For what purposes does the State borrow money in old countries? in new countries?
14. How may debt be paid off or the burden of interest reduced?

COURSE IN ECONOMICS

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